NOV

2

1982

BEST AVAILABLE COPY

Securities Industry Trends

AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

A8825-1 11/2/82

Vol. VIII No. 6 November 2, 1982

UPDATE 1982: FROM RAGS TO RICHES

HIGHLIGHTS

1. During the first half of 1982, the industry earned an estimated after-tax ROE of 7.3%. Almost two-thirds of the industry's pre-tax profits were earned by the ten large investment banking firms (2.6% of the NYSE firms dealing with the public).

2. Concentration increased sharply during the first half of 1982. The 25 largest firms hold 73% of industry capital and receive 77% of revenues. These figures highlight the emergence of extremely large firms owned, in several instances, by non-Wall Street parents.

3. The retail investor was almost invisible during the second quarter. Sharp volume increases in Amex and NASDAQ stocks together with a spurt in "estimated" retail activity on the NYSE suggest that the third quarter rally was broader than simply institutional in scope.

4. From quarter to quarter, the principal business now makes or breaks the securities industry. Trends in fixed income prices are the key determinant affecting trading profits. The second quarter of 1980 is a benchmark for judging the industry's trading profits ($1.1 billion). Given a 12% rise in the Dow Bond Average, interest rates, and the level of net long positions ($18.6 billion) at the beginning of July, we estimate that third quarter trading profits (including accrued interest) will be spectacular, approaching the $2 billion level.

5. The securities industry continued to spend impressive amounts towards coping with an erratic yet ever-greater transaction flow. This helps explain why the continuing surge in volume has been handled without a hitch so far.

6. The prospect of lower interest and inflation rates raises questions about the outlook for product lines which were so successful just six months ago and which depository institutions seem so eager to enter now. All financial intermediaries should reevaluate whether those products and services linked closely to high and volatile interest rates will flourish as well in the next few years as in 1979-81.

Securities Industry Association
120 Broadway • New York, N.Y. 10271 • (212) 425-2700

Introduction

For the securities industry, 1982 has been the best of times and the worst of times. For the first six months, gross revenues dipped 3.4% from their 1981 level, while pre-tax net plunged 64.6%. The industry's estimated after-tax return on equity, annualized, was a discouraging 7.3%. However, a thunderous market has been under way since mid-August. Triggered by the realization that a sluggish economy can accommodate immense Federal borrowing needs along with falling prices and interest rates,[1/] the rally illustrated anew the feast-or-famine nature of this business. The current rally came hard on the heels of a disappointing twelve months. Over that time, the only bright spot was the earnings performance of a small number of institutional firms. In the first six months of 1982, the ten Large Investment Banking firms[2/] (with only 29.0% of aggregate equity capital) accounted for 64.0% of the industry's pre-tax profits.

The most important questions about the current market revival, aside from the most basic one as to its sustainability, involve how fully it can spread from first- to second- and third-tier stocks and, relatedly, from the institutional to the retail sphere. The greatest hope of retail firms at present is that a sustained decline in short-term interest rates will propel some fraction of the $220-plus billion and the $50-plus billion now invested in Money Market Funds and maturing All-Savers Certificates, respectively, into common stocks. According to some firms, this transfer has already begun.

This Trends will examine the reasons behind the industry's weak earnings performance in early 1982. In a departure from usual practice, some attempt will be made to estimate the extent of the third quarter improvement. Also discussed are several key regulatory measures now pending.

Securities Firm Valuation

The startling series of mergers that began in early 1981 has focused great interest on the valuation of securities firms, a subject somewhat neglected previously. The labor-intensive nature of this business results in a firm's value being in large measure intangible, while the volatility both of earnings and of

---

1/ During the last 12 months, the CPI fell from almost a 13% rate of increase to just under 4.9%. Meanwhile, yields on 3-month Treasury bills plummeted from almost 15% in September 1981 to about 8% in September, 1982. At the same time, the budget deficit was running in triple figures.

2/ As classified by SIA and the SEC.

P/E multiples further complicates the issue. The relationship of market to book value is, accordingly, a useful measure.

The investment community's own appraisal of securities firms' earnings potential is highly revealing. Those mergers taking place in mid-1982 were effected at premiums over book perceptibly lower than the norm of a few months earlier. Shown below are the ratios of year-end market to book value for the five largest publicly owned brokerage firms. The improvement since 1977 is very dramatic, for the industry was then faced with mediocre markets and newly confronted with price deregulation besides. Market volume began its dramatic climb in April 1978, while interest rates were launched on their present erratic course a year and a half later. The securities industry's success in handling these developments explains much of the ratio improvement shown below. Over the third quarter of 1982, the share prices of these five firms rose by an average of 39.7%, outperforming all major market indices. The stocks of publicly held securities firms continue to be excellent proxies for price and volume trends in the capital markets.

Table 1

Ratio of Year-End Market to Book Value for Publicly Owned Firms

	1981	1980	1979	1978	1977
DLJ	1.88	1.12	0.58	0.55	0.48
First Boston	1.04	1.02	0.61	0.63	0.68
E. F. Hutton	2.02	1.70	0.81	0.69	0.67
Merrill Lynch	1.10	1.42	0.89	0.80	0.82
Paine Webber	1.12	1.59	0.80	0.90	0.59

Recent earnings performance is another crucial factor in valuation decisions. The contrasting experience of various industry segments is clear in the numbers below. The consistent strength of the Large Investment Banking firms is readily apparent. The third quarter upsurge appears to have been across the board, yet those firms strongest in the second quarter may well come out on top again in the third because of their emphasis on institutional business and the fixed income market.

Table 2

After-Tax Return on Equity

	1981					1982		
	1Q	2Q	3Q	4Q	Full Year	1Q	2Q	6 Months
All Firms	26.2%	22.8%	7.8%	21.1%	19.2%	5.4%	9.0%	7.3%
National Full Line	20.6	19.4	3.6	10.8	13.2	(1.0)	4.1	1.8
Lg. Invest. Banking	34.1	28.7	22.9	36.8	29.8	15.2	17.2	16.2
All Regionals	25.2	29.0	9.4	19.5	20.4	4.6	6.8	5.7
All NYC Based	35.9	25.0	5.3	28.6	24.1	1.6	8.3	4.6

Concentration

Concentration tends to increase during business slowdowns, and early 1982 was no exception. Subsequent upswings tend to arrest yet not reverse the trend towards a more concentrated industry. The number of NYSE firms dealing with the public held nearly steady at 388, yet this figure can be deceptive, since the absorption of a full-service firm can be counterbalanced by the entry of a smaller, boutique-type enterprise. Concentration figures are shown in Table 3.

Table 3

Market Share of Largest Firms, 1975-1982

Gross Revenue

	1975	1976	1977	1978	1979	1980	1981	6 Mos. 1982
Top 10	40.1%	41.6%	41.4%	44.5%	48.4%	52.8%	55.5%	59.1%
Top 25	58.1	60.3	62.4	70.7	70.1	72.3	74.4	76.9

Commissions

	1975	1976	1977	1978	1979	1980	1981	6 Mos. 1982
Top 10	32.8%	34.6%	33.7%	37.9%	39.1%	44.1%	42.5%	42.7%
Top 25	52.8	53.9	55.4	64.8	63.6	64.6	63.0	63.4

Year-End Total Capital

	1975	1976	1977	1978	1979	1980	1981	6 Mos. 1982
Top 10	42.5%	43.8%	43.5%	44.9%	46.8%	50.1%	51.9%	54.4%
Top 25	59.5	61.3	64.3	68.9	67.7	68.9	71.4	73.4

The increase in concentration is very marked for a six-month period. The gross revenue figures are arguably distorted by trading revenues, a business line dominated by the largest firms, yet the increase in capital concentration is nearly as great. The lower concentration rate for commissions reflects the two-tiered commission rate structure. The largest firms' share of actual volume is very much greater. The Top Ten firms accounted for all of the increase in concentration; the share of the firms ranked eleven through twenty-five actually declined. This highlights the emergence of a new stratum of extremely large firms, frequently owned by non-Wall Street parent corporations.

This trend appears likely to continue, given the oft-displayed willingness of smaller firms to sell, and of larger firms to buy.

Revenues

The 3.4% drop in gross revenues from the first half of 1981 lay at the root of the industry's problem. The declines in commissions and margin interest were particularly pronounced, indicative of a higher institutional profile in the agency business. In this connection, it is noteworthy that commissions for listed equity transactions showed a smaller decline than did "Other Commissions." In the second quarter of 1982, trading revenues exceeded total commissions, though this was neither for the first nor, presumably, the last time. The inclusion of accrued interest in these trading figures produces a gross distortion; the severe drop in investment revenues provides a better clue as to the disappointing security price trends during this period. Industry revenues thus experienced a greater qualitative than quantitative change.

Table 4

Securities Industry Revenues Breakdown, 6 months 1982
(millions of dollars)

	1Q	2Q	6mo. 1982	Percentage Change 6 mo. 1982-1981
Commissions:				
Listed equities on an Exchange	$ 862	$ 838	$1,699	(20.0)
Options	151	130	280	(10.5)
Other	144	145	291	(29.7)
Total	1,157	1,113	2,270	(20.4)
Trading	1,073	1,227	2,300	12.3
Investment	(1)	72	72	(81.2)
Margin Interest	587	556	1,143	(20.5)
Underwriting	361	436	797	(5.6)
Mutual Fund Sales	36	65	100	63.9
Account Supervision	71	78	148	15.6
Research	2	3	4	(20.0)
Other-Related	892	953	1,844	49.6
Commodities	141	156	296	6.5
Other-Unrelated	222	293	515	(8.7)
TOTAL	$4,536	$4,949	$9,485	(3.4)
Net Income Before Taxes	170	292	462	(64.6)

The decline in margin interest blighted the retail segment of the business. The volume of margin lending is of course correlated with retail transaction flow. More importantly, it

allows for a highly profitable utilization of float. The growth of mutual fund sales is interesting in light of the overall retail stagnation. Other related revenues exceeded listed equity commissions for this period, another milestone. This is another interest rate phenomenon, reverse repo earnings being the main component of Other Related revenues, which also include M&A fees.

The Agency Business

The agency business remains the most visible, if no longer the most significant, determinant of profitability. The 20.4% drop in commissions for the first half of 1982 occurred despite a pronounced rise in NYSE volume. Several factors were at work to produce this apparent contradiction. Foremost among these is the differential between institutional and retail transaction costs. The NYSE Public Transaction Study (PTS), the most current covering the fourth quarter of 1980, revealed that the secular trend toward institutionalization had continued, with the institutional/retail breakdown of NYSE public volume 64.9%/34.1%, up from 57.3%/42.7% in the 1976 first quarter. Numerous estimates are shown in the table below where it is possible to derive some rough feel for the sluggishness of retail business during the Spring of 1982.

Table 5

Estimating Retail Market Trends

	4Q 1980	1Q 1981	2Q 1981	3Q 1981	4Q 1981	1Q 1982	2Q 1982	3Q 1982
(1) NYSE Average Daily Volume (mils. shares)	48.8	47.3	49.6	44.3	46.1	51.6	52.0	68.1
(2) 10,000-share blocks as a % of NYSE Volume	29.0	29.5	32.6	31.7	33.4	36.8	42.9	43.0
(3) Member Trading as a % of NYSE Volume	27.1	26.5	26.6	26.7	27.0	27.6	28.2	27.1
(4) "Retail" NYSE Average Daily Volume (mils. shs.) (1 - [2 + 3])	21.4	18.9	20.2	18.4	18.3	18.4	15.0	20.4

The figures above can be interpreted in a way that overstates the institutional share, since some of the large block trading is for members' own accounts. The point is that very little large block trading is retail. Nor is it sufficient to inspect NYSE data only. Institutions, for risk and liquidity considerations, remain heavily committed to NYSE stocks. The PTS reports institutions' share of public volume on other markets to be 32.4%, one-half their NYSE percentage. Table 6 reveals further insights into the lackluster retail market during the first half of 1982.

Table 6

Volume and Stock Price Trends
(Volume in millions of shares)

	4Q 1980	1Q 1981	2Q 1981	3Q 1981	4Q 1981	1Q 1982	2Q 1982	3Q 1982
NYSE Average Daily Vol.	48.8	47.3	49.6	44.3	46.1	51.6	52.0	68.1
NYSE Composite, End of Quarter	77.86	78.27	76.15	67.00	71.11	64.52	63.02	69.18
Amex Average Daily Vol.	7.3	5.5	6.0	5.1	4.7	4.5	4.0	4.7
Amex Mkt. Value Index, End of Quarter	348.99	360.60	374.63	292.86	320.63	260.12	250.79	283.18
NASDAQ Average Daily Volume	36.8	30.9	34.2	29.3	29.9	26.9	27.2	30.6
NASDAQ Composite, End of Quarter	202.34	210.18	215.75	180.03	195.84	175.65	171.30	187.65

While the NYSE and NASDAQ price indices have moved closely in tandem, NASDAQ volume underwent nothing like the NYSE trading explosion in the quarter just ended. Amex stocks experienced the greatest price drop since mid-1981. Amex stocks have the heaviest energy weighting, and investor disenchantment with energy stocks has rocked the capital markets over the past twelve months. The large capitalization stocks typically ignite a broader-based market rally.

During the third quarter, the AMEX Index rose 13% as compared to 10% for both the NYSE and NASDAQ Composites. With sharp volume increases in AMEX and NASDAQ stocks along with a spurt in "estimated" retail activity on the NYSE, the third quarter rally was more than simply institutional in nature. Apparently, the institutions ignited the rally, as usual, and retail investors followed with a short lag. When third quarter commission revenue figures arrive from the regional firms based in and outside of New York, we will have a better idea about the extent of retail participation. Currently, we would conclude that retail activity has been greater than initially suggested in press accounts of the rally.

Margin lending is an integral part of retail brokerage. In this business, rising interest rates benefit the retail firm, since the firm's own cost of funds lags the rate charged on debit balances. The drop in retail trading volume produced a similar drop in debit balances. It is striking that the third quarter rally produced no increase in margin debt outstanding. Several publicly owned wirehouses are known to operate profitably only through net interest income, and the drop in interest rates since mid-1981, so beneficial in other respects, has eroded margin lending's profitability. Data on margin lending are shown in Table 7. The third quarter leap in credit balances is especially important for retail firms and probably reflected funds temporarily "parked" from recent sales of stocks or maturing

instruments. Many retail investors were understandably puzzled about the future direction of fixed income yields and stock prices, having seen short-term rates drop by one-third and the Dow jump by 14% in just three months. Aggregate data are not currently available on the extent to which credit balances earn interest. This practice and the related growth of sweep accounts threaten this source of profits.

Table 7

Customer Debt and Balances
(End of Quarter, millions of dollars)

	4Q 1980	1Q 1981	2Q 1981	3Q 1981	4Q 1981	1Q 1982	2Q 1982	3Q 1982
Debit Balances	14,500	14,020	14,880	13,760	14,150	11,840	11,540	10,950
Credit Balances	8,175	8,870	9,000	9,495	10,665	10,405	10,560	12,465
Broker/Dealer Call Rate (3-month average)	16.48%	18.45%	18.86%	19.17%	14.85%	15.11%	15.48%	12.51%

Trading

More than any other product line, the principal business makes or breaks the securities industry from quarter to quarter. The business is overwhelmingly influenced by trends in fixed income prices. As demonstrated by the industry's second quarter 1980 experience, a strong trading quarter can more than offset any conceivable slump in other product lines. Trading profits will be the chief determinant of the aggregate third quarter profit figures to be released next month. Those trading results will, we believe, be spectacular.

Trading results were anything but spectacular for the first six months of the year. As noted, the inclusion of accrued interest in trading revenues renders those figures meaningless. Even though trading revenues were at a record level trading results were evidently disappointing. Figures for gains on investment accounts exclude accrued interest, and they were down more than 80% from their year-earlier level. The failure of interest rates to fall in step with the inflation rate produced unprecedented real rates of interest. This puzzling situation resulted, in no small part, from anxiety over fiscal policy. At work was a pronounced shift of power in favor of creditors, an important manifestation of which was the widely noted flight into quality. By September 1982, the yield on Aaa corporate debt was only 83% of that available on Baa debt, down from 92% a year earlier.

Interest rates, though high, displayed unusual stability in early 1982. The sudden fluctuations which increase traders' potential for gain -- and loss -- were conspicuously absent. Due to the huge growth in financial futures trading, the direction of a market swing is almost less important than its magnitude, for

trading purposes. The Large Investment Banking firms maintained a dominant position in the principal business, accounting for 47.1% of aggregate trading revenues for the first half and 65.4% of average net long positions over the same period. Their 87.5% share of investment gains (excludes interest) suggests that their trading figures would look well if adjusted for financing costs. Aggregate trading revenues for OTC equities were $214 million through June 1982, down 41% from the year earlier figure, yet another dimension of the retail stagnation.

Hedging and shorting strategies notwithstanding, a drop in interest rates still provides a powerful stimulus. The second quarter of 1980 saw such a drop and indeed at $1.1 billion, remains the benchmark for judging trading success. Although the third quarter of 1982 produced a smaller but still impressive rate decline, the higher level of volume will swell trading profits. We would project that third quarter trading profits may approach the figure for the entire first half of 1982, around $2 billion.

The results of the publicly-owned firms now coming in reflect huge principal gains. Short-term rates are of course more volatile, but a fall in long-term rates produces far greater price appreciation. The table below shows the Dow Jones Twenty Bond Average close for every Friday of these two quarters.

Table 8

Dow Jones Twenty Bond Average, Weekly Close

Second Quarter 1980		Third Quarter 1982	
April 4	64.19	July 2	57.90
April 11	66.64	July 9	58.51
April 18	68.87	July 16	58.95
April 25	70.70	July 23	60.03
May 2	71.71	July 30	59.75
May 9	72.39	August 6	60.02
May 16	72.32	August 13	60.06
May 23	72.28	August 20	62.31
May 30	72.55	August 27	62.96
June 6	73.22	September 3	63.52
June 13	74.81	September 10	63.68
June 20	76.60	September 17	63.73
June 27	75.35	September 24	64.71

These figures reveal an 11.8% price appreciation for the third quarter of 1982, as compared to a 17.4% (12% in April alone) second quarter 1980 figure. The more recent bond rally has continued through October, with the Twenty Bond Average at 70.00 as of this writing. In addition, the scale of trading has grown larger. The industry entered the third quarter of 1982 with net long positions of 18,588 million, 97% higher than the

figure as of March 31, 1980. The above numbers indicate that the quarter just ended was one of exceptional profitability. When third quarter results are made available, they are apt to reveal results strikingly similar to the record second quarter of 1980.

Underwriting

Underwriting revenues for the first six months of 1982 registered a surprisingly modest 5.6% decline from their year-earlier level. A $7.9 billion drop in corporate offerings was offset by a rise of the same amount in municipal volume. Many symptoms of a bad market were discernible between January and June. In fact, given the drop in those offerings which entail the biggest spreads, the stability of underwriting revenues may be due to reporting inconsistencies. Initial public offering volume, at $438 million, was off 77.4% from its 1981 level, though remaining far above pre-1980 volume. Utilities accounted for 45.3% of the value of all common stock offerings during the first half of the year, up from 36.1% in the comparable 1981 period. Competitively sold corporate deals accounted for a strikingly low 5.9% of primary market volume, and an appetite for higher-grade credits became pronounced among all classes of debt investor, from pension funds to money market funds.

The secondary market revival of the third quarter spread quickly to the primary market, and third quarter underwriting revenues, when reported, should show a comparable leap. Third quarter corporate underwriting volume reached $21.4 billion, a 140% increase over the 1981 third quarter. We should caution, however, that these figures include the par value and not the sale proceeds of zero-coupon and other discount debt issues.

Probably the most significant underwriting development of early 1982 was the SEC's promulgation of Rule 415 on a nine-month trial basis in February. That trial period has since been extended through December 1983. Rule 415 allows for the so-called shelf registraton of securities a corporation expects to issue within a two-year period. Presented as a purely procedural step, part of the overall integration of 1933 and 1934 Act disclosure requirements, the shelf rule seems bound to alter, to some extent, the structure of the investment banking industry.

Shelf registration, in essence, makes primary market distributions more similar to secondary market transactions. It also has the potential to sever existing client relationships. AT&T, for instance, largest of all corporate issuers and the ultimate retail stock, named twenty-one potential managing underwriters in its first shelf filing of 10 million common shares. More than anything else, Rule 415 has resulted from issuers arguing that they need to enter volatile markets more quickly. The same time considerations that have streamlined the registration process have wrought a similar streamlining of the syndication process. Something resembling a Euro-market "bought deal" is often the result. It is noteworthy that 41% of the

principal amount of third quarter 1982 debt offerings was taken off the shelf. A recent Wall Street Journal article quotes a Merrill Lynch estimate that shelf deals now account for 20% of the funds raised in the U.S. since March of this year.

Below are figures on the largest firms' underwriting market share over time. Bad markets, other things equal, lead to greater concentration, since they tend to exclude smaller issuers which are the stuff of Regional firms. The jump in concentration between 1976 and 1977, therefore, seems as much a result of a market downturn as of the mergers then in process. The fall in concentration between 1980 and 1981 reflects the extremely broad-based nature of primary market prosperity during the first half of 1981. The concentration figures for early 1982 display a particularly dramatic jump, more pronounced in the second quarter than in the first. This is only partly due to market conditions and seems a shelf-related harbinger of things to come.

Table 9

Underwriting Market Share of the Largest Firms, 1976-1982

	1976	1977	1978	1979	1980	1981	1Q 1982	2Q 1982
Top 10	46.2%	47.8%	50.7%	49.1%	53.1%	50.3%	58.4%	57.1%
Top 25	66.4	69.2	75.3	70.9	75.3	73.0	78.7	80.0

Other Revenue Sources

The greatest increase was in mutual fund sales, a relatively unimportant product line. Net sales of open-end funds (excluding Money Market Funds) rose to $1.9 billion for the first half of 1982, up from just under $900 million in the same 1981 period and just $73 million in 1980. It seems likely that market volatility increases the appeal of the diversification which these funds offer. Mutual funds are also an important device for drawing first-time investors into equities.

The drop in Other Unrelated Revenues is not very revealing, since diversification now takes place outside the FOCUS reporting framework. The 6.5% rise in Commodities income, similarly, can probably be attributed to the financial futures business, given the softening of commodities prices since mid-1981.

The most noteworthy rise was that in Other Revenues Related to the Securities Business, and the burgeoning of repo matching underlies this. The rise seems more attributable to volume than to interest rates. Data are given below. Repo matching enables broker/dealers to utilize their institutional contacts in what is ideally a low-risk manner. They are an outlet for idle cash for those who purchase to resell and a source of liquidity for those who sell to repurchase. The failure of two highly leveraged government dealers this year has brought home the fact that,

while the securities bought and sold may be riskless, some of the market participants are anything but.

Table 10

Repo Business, 1981-82
(dollars in billions)

	1981				1982	
	1Q	2Q	3Q	4Q	1Q	2Q
Securities Purchased under Agreement to Resell	$23.9	$27.8	$32.4	$42.4	$32.3	$39.1
Securities Sold under Agreement to Repurchase	38.1	36.7	38.2	51.7	45.9	48.3
6-month T-Bill Rate (average)	14.12%	15.13%	16.32%	13.55%	14.33%	13.80%

M&A fees are another component of Other Related revenues. The first half of 1982 saw a drop in the mega-deals which characterized the business in 1981. There were 1,198 merger transactions valued at $27.8 billion through June 1982, compared to 1,184 transactions valued at $33.7 billion in the comparable 1981 period.3/ A sustained drop in rates can be expected to stimulate this business, since it would increase the feasibility of all leveraged purchases. This would serve both to swell M&A fees and to provide stock prices generally with additional support.

Expenses

The industry's expense picture for early 1982 illustrates the need to control overhead in a volatile business. The small increase in interest, now the dominant expense, seems due to the drop in margin lending activity. Those expenses that comprise overhead -- Clerical & Administrative, Occupancy & Equipment, Communications, Promotional, and EDP Equipment Costs -- all showed increases. The most modest rate of increase for a fixed cost was that of Clerical & Administrative. Expenses for the six month period are tabulated below.

3/ Source: W. T. Grimm & Co.

Table 11

Securities Industry Expense Breakdown, 6 Months 1982
(millions of dollars)

	1Q	2Q	6 mo. 1982	Percentage Change 6 mo. 1982-1981
Floor Brokerage & Clearance	$ 176	$ 178	$ 354	(6.6)%
RR Compensation	774	813	1,586	(3.3)
Clerical & Administrative Employee Expenses	780	817	1,596	5.5
Communications	300	310	609	19.9
Occupancy & Equipment	196	206	401	26.9
Promotional Costs	115	123	238	12.3
Interest Expense	1,393	1,549	2,942	9.4
Losses in Error Accounts and Bad Debts	31	29	59	(25.3)
EDP Equipment Costs	60	68	127	38.0
Regulatory Fees & Expenses	22	20	42	13.5
Partners' & Voting Stockholders' Salaries	168	155	322	(1.2)
Other Expenses	352	389	747	2.3
TOTAL	$4,367	$4,657	$9,023	5.9%

The increases in communications (20%), occupancy & equipment (27%), and EDP costs (38%) over the first half of 1981 reflect the industry's commitment to upgrade their back office capacity. This objective was maintained even in a climate where revenues and profits, in particular, were lagging. The improved systems and facilities were very evident during the third quarter when the surge in volume was handled without a hitch. Industry spokesmen can point with pride to an area where the industry continues to commit impressive sums towards coping with an erratic yet ever-greater transaction flow.

Volume-related expenses, especially those related to retail volume, showed declines. The greatest drop is that in Error Accounts, a barometer of retail activity. Of the $503 million by which expenses were up in the period, interest accounted for $254 million or 50.5%. The other culprit items can be identified in the table below.

Table 12

Expense Categories' Percentage Contribution to Expense Increase, First Half 1982 - First Half 1981

Floor Brokerage & Clearance	(5.0)%	Error Accounts and Bad Debts	(4.0)%
RR Compensation	(10.7)	EDP Equipment Costs	7.0
Clerical & Administrative Employee Expenses	16.5	Regulatory Fees & Expenses	1.0
Communications	20.1	Partners' & Voting Stockholders' Salaries	(0.8)
Occupancy & Equipment	16.9	Other Expenses	3.4
Promotional Costs	5.2	Total Expense Increase	100.0%
Interest Expense	50.5	Total Increase ($ Millions)	503

Regulatory Developments

The interest rate experience of the past three years has rendered somewhat outmoded the legislatively-defined roles for different classes of financial institution. The thrifts are the most visible instance as the recent financial turmoil has undermined both their passbook deposit base and their basic "borrow short, lend long" philosophy. An inverted yield curve and perceived regulatory inconsistencies have produced a large number of new financial products. For the securities industry, the thrifts' greatest significance lies not in the marketing potential of their deposit base but in their role as a catalyst in forcing a reappraisal of the existing regulatory scheme. Unfortunately, regulatory concessions to thrifts are frequently extended to commercial banks, the ill-conceived All Savers' Certificate being a case in point. Commercial banks pose an infinitely greater competitive challenge to broker/dealers than do thrifts, and the Glass-Steagall Act will be the subject of Congressional hearings during 1983.

Revenue bonds were long the main bone of contention between banks and broker/dealers. Money market funds, CMA-type accounts, and alleged broker/dealer deposit-taking have more recently been the focus of this controversy. The most significant development of the past year, however, has been the entry of commercial banks into discount brokerage, either by networking, as in the cases of Citicorp and Security Pacific, or by outright acquisition, as the Bank of America proposes to do. The Glass-Steagall Act makes an exception allowing commercial banks to furnish "accommodation brokerage" services. The securities industry argues that accommodation brokerage is a very different thing from wholesale entry into the discount brokerage business, and that this decision is more properly a legislative than a regulatory one. Bank and thrift regulators apparently do not see it this way and have been approving applications by entities falling under their purview to offer discount brokerage services. With the recent plunge in interest rates, the need for regulators of deposit-taking institutions to allow their entities to offer other services may well be lessened. Oversight of problem loans

to foreign nations and corporations would seem an at least comparably pressing matter.

Discounters will face very stiff future competition, if customers can handle transactions through commercial bank branches. It is unclear, however, to what extent discounters and full service firms compete directly. Full service firms compete vigorously through the quality of service, particularly the quality of investment advice. Low transaction costs are small consolation where poor advice has been given. Nevertheless, it is hard to overstate the potential significance of commercial bank entry into the retail securities business.

Conclusion

The securities industry's performance during the quarter just ended seems to ensure that full year 1982 earnings will reach a respectable level. Whether 1982 turns out to be a spectacular year will depend on the fourth quarter. The future course of interest rates will determine the level of stock and bond prices, and some control over government spending and the deficit is an important precondition to non-inflationary economic growth.

High and erratic interest rates have created a wide range of new financing and investment strategies, both short- and long-term. These range from zero-coupon and floating-rate debt through repos and financial futures to asset management and zero-balance bank accounts. In the process, the business of inventorying bonds has become one of anticipating sharp and sudden interest rate changes. The retail brokerage business has focused on utilizing customer float. The income statements and balance sheets of securities firms have been revolutionized accordingly.

The prospect of a milder monetary climate raises interesting questions about the business mix that has evolved. Post-1979 interest rate behavior has had powerful regulatory repercussions, which have not yet run their course. Retail investors will presumably never again settle for a Federally-mandated, sub-market rate of return. Lower and more stable interest rates would diminish the profitability of several key product lines, yet they would provide an immense stimulus to such traditional products as the agency equity business and underwriting as has been the case recently.

The important recent mergers are in large measure an outgrowth of high and volatile interest rate conditions, since the competition to provide new products has narrowed the gap dividing different financial institutions. During the third quarter, the return to profitability of the old-line staple products was very evident. This may put the hectic diversification of the recent past in a different light. The time may have come for firms to redirect their efforts towards those products and services which will be most in demand during

periods of lower inflation and interest rates. Alternatively, the trends started in the 1970's may be irreversible and customers -- issuer, institutional and retail -- may continue to require an increasingly sophisticated and diverse array of products and services. If so, an industry noted for entrepreneurial skills, risk-taking and salesmanship should continue to prosper in any reasonably favorable tax and regulatory climate.

Jeffrey M. Schaefer
Senior Vice President and
Director of Research

Timothy Y. Smith
Assistant Director
of Research

SECURITIES INDUSTRY STATISTICS

VOLUME

	August 1982	YEAR-TO-DATE 1982	August 1981	YEAR-TO-DATE 1981	% CHG. Y-T-D 1982 - 1981
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	76.0**	55.2	43.8	47.2	16.9%
AMEX (MILS.)*	5.6	4.3	5.1	5.5	(21.8)
NASDAQ (MILS.)*	30.9	27.5	29.6	31.6	(13.0)
REGIONAL EXCHANGE (MILS.)*	10.8	7.7	6.1	6.1	26.2
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	46,181**	260,410	30,243	271,629	(4.1)
AMEX (MILS.)	1,213	8,666	2,154	17,374	(50.1)
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	5,436	37,120	4,366	43,547	(14.8)
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	12,578	78,945	11,117	94,253	(16.2)
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	42.8	40.7	31.8	31.3	30.0
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	8,361	45,512	4,641	35,098	29.7
AMEX OPTIONS	3,994	22,678	2,877	21,920	3.5
COMMODITY	10,826	72,382	8,347	60,039	20.6

** MONTHLY AVERAGE*

** New High

YIELDS

(MONTHLY AVERAGES)

	August 1982	August 1981	Basis Point Change
BOND BUYER INDEX (20 BOND)	11.23	12.26	(1.03)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	13.71	14.89	(1.18)
Baa CORPORATE	16.32	16.34	(0.02)
RATIO Aaa CORPS. TO Baa CORPS.	0.84	0.91	(0.07)
MUNICIPAL BOND YIELDS (MOODY'S)	10.68	10.10	0.58

PRICES

(END OF MONTH)

	September 1982	September 1981	% Change 1982 - 1981
DOW JONES INDUSTRIALS	896.25	849.98	5.4%
STANDARD & POOR'S 500	120.42	116.18	3.6
NYSE COMPOSITE	69.18	67.00	3.3
AMEX MARKET VALUE INDEX	283.18	292.86	3.3
VALUE LINE COMPOSITE	131.95	129.76	1.7
NASDAQ COMPOSITE	187.65	180.03	4.2

UNDERWRITING
(DOLLARS IN MILLIONS)

CORPORATE FINANCING (Gross New Issues)	September 1982	Yr.-To-Date 1982	September 1981	Yr.-To-Date 1981	% Change September '82 September '81	% Change Yr.-to Date
Total	6,796	48,253	3,318	43,741	104.8%	10.3%
Competitive	517	2,266	175	3,657	195.4	(38.0)
Negotiated	6,279	45,987	3,143	40,084	99.8	14.7
Common Stock	1,270	8,721	625	12,278	103.2	(29.0)
# Of Common Stock Issues	47	417	51	713	(7.8)	(41.5)
Preferred Stock	475	3,541	40	1,312	1087.5	169.9
# Of Preferred Stock Issues	8	58	2	32	3.0	81.3
Corporate Debt	5,054	35,992	2,653	30,150	90.5	19.4
# Of Corporate Debt Issues	55	372	29	319	89.7	16.6

MUNICIPAL FINANCING* (Gross New Issues)	August 1982	Yr.-To-Date 1982	August 1981	Yr.-To-Date 1981	% Change August 1982 - August 1981	% Change Yr.-To-Date
Total	10,627	72,197	5,172	49,312	105.5%	46.4%
Notes	4,542	29,903	2,084	20,449	117.9	46.2
Bonds	6,090	42,290	3,090	28,860	97.1	46.5
# of Bond Issues	365	3,147	369	2,893	1.2	8.8
Negotiated Bonds	4,320	29,020	1,990	16,930	117.1	71.4
Revenue Bonds	4,110	28,640	2,020	18,880	103.5	51.7

*Preliminary Figures

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	August 1982	Year-to-Date 1982	August 1981	Year-to-Date 1981	% Change, Y-T-D '82 to Y-T-D '81
NET SALES*	579.5	2,800.9	(31.0)	905.0	209.5%
NET PURCHASE OF COMMON STOCK*	647.5	405.4	70.5	(104.0)	(289.8)
NET PURCHASE OF OTHER SECURITIES*	714.5	1,620.8	98.5	1,167.8	38.8
MUTUAL FUND CASH POSITION	11.6	---	10.4	---	------

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS

MARGIN DEBT

	August 1982	August 1981	% Change Aug.'82-Aug.'81
MARGIN DEBT OUTSTANDING ($MILS)	11,150	14,310	(22.1)%
NET CHANGE IN MARGIN DEBT ($MILS)	(3,160)	2,510	(25.9)
% OF ACCOUNTS WITH EQUITY UNDER 40%	9%	15%	----

* ALL TIME HIGH

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	Second Quarter 1982	Yr.-To-Date 1982	Second Quarter 1981	Yr.-To-Date 1981	% Change 2nd Q. 1982 2nd Q. 1981	% Change Yr.-To-Date 1982 - 1981
REVENUE						
SECURITIES COMMISSION INCOME	1,115	2,272	1,483	2,856	(24.8)%	(20.4)%
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	1,298	2,370	1,062	2,428	22.2	(2.4)
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	436	796	494	844	(11.7)	(5.7)
TOTAL REVENUE	4,953	9,488	4,971	9,832	(0.4)	(3.5)
TOTAL EXPENSES	4,662	9,027	4,342	8,535	7.4	5.8
NET INCOME BEFORE TAXES	291	461	629	1,297	(53.7)	(64.5)
PERCENT OF FIRMS SHOWING LOSS	37.9%	40.3%	15.6%	15.9%	---	---

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
"Capital Markets Serving Small Business: Implications of the Rapid Evolution of the Financial Services Industry"	This study explores implications of developments in capital markets and the extensive changes taking place in the financial services industry for the financing of small business.	Order from: Irving Leveson, Director of Economic Studies Hudson Institute, Quaker Ridge Road, Croton-on-Hudson, New York, N.Y. 10520
"The Silver Crisis of 1980"	This report embodies the findings and conclusions of the Commission staff with particular emphasis on the role of certain silver traders and the securities industry participants in the events leading to the crisis of 1980 and the impact of those events on the industry.	A Report of the Staff of the U.S. Securities and Exchange Commission October, 1982
"Part 4 of NYSE Response to the SEC concerning an Order Exposure Rule."	Part four of a series of comment letter filed with the Securities and Exchange Commission, which summarizes the New York Stock Exchange's position on an order exposure rule. The letter basically stresses the need for such a rule and gives definite reasons why.	Order from: NYSE Printing and Distributing Section (212) 623-7605
"Are the New Economic Models the Answer?"	A short article based on the recent publication of collected papers by Robert Lucas and Thomas Sargent. It depicts the coming of age of the new "rational expectations" or "equilibrium" model of business cycle. The article tries to explain the new ideas themselves, critiques the mainstream approach by the new theorists, and lastly the author's critique on what is wrong with these new ideas.	The Brookings Review Fall, 1982

ITEM	DESCRIPTION	SOURCE
"Trade Policy and the U.S. Economy"	An informative article which decries the use of protectionism in world trade. The author refers to such protectionist policies as devaluation, trade and trade balances, currency devaluation, tariffs and quotas. The article also discusses the Reagan Administration's consideration of a new trade policy based on "reciprocity." A potentially radical change which invites further protectionism among industrial countries, is the authors view of "reciprocity."	Financial Analysts Journal September/October, 1982
"Battle of the Brokers"	Interesting insights developing as a result of George Ball's move to head Prudential-Bache Securities Inc. The article goes beyond the trend of key employee movement from Hutton to Prudential-Bache and focuses on the question of firms' proprietary hold on key performers.	Barron's November 1, 1982
"Toronto Tracks the Price/ Eating Ratio?"	A brief article about the recent performance of the Canadian stock market. The author compares the strength of the stock market with the availability of tables at bars and restaurants in the financial district. The Canadian stock market is trailing the New York stock market in this latest upsurge.	The Economist October/November, 1982

Sandra N. Gallier

DEC

6

1982

BEST AVAILABLE COPY

Securities Industry Trends

AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

A8825-1 12/30/82

Vol. VIII No. 7 December 6, 1982

THE IMPACT OF BANKING INDUSTRY SPONSORSHIP OF DISCOUNT BROKERAGE FIRMS ON THE SECURITIES INDUSTRY

HIGHLIGHTS

1. Even without specific legislation, commercial banks are entering the discount brokerage business. Some banks are offering discount brokerage through a wholly-owned subsidiary, while others have networking arrangements with broker/dealers. The form may vary, but the fact is that banks are now offering this service.

2. The level of securities industry commission revenues is determined not only by exchange volume but by the institutional/retail breakdown of trading volume. It is estimated that, in 1981, individuals accounted for 56.7% of commission revenues but only 30.4% of exchange volume due to differences in order size and transaction activity between institutional and retail customers. At full service firms, commissions on institutional trades averaged 10.5 cents per share, one-third the estimated retail rate.

3. In 1980, individuals had an estimated 11% turnover rate while for many institutions it was nearer 40%. Transaction cost differentials and differences in tax status explain much of this discrepancy. A return to the six-month holding period for long-term capital gains could increase retail turnover and volume sharply.

4. Discounters' retail volume market share for early 1982 is estimated at 13%. Commercial banks will probably come to dominate the discounter market while increasing the market share of the discount segment of the industry.

5. Exchange volume is determined by a number of factors, including number of shares outstanding, capital gains tax rates, general economic uncertainty and the degree and direction of average stock and bond price changes on a daily basis. Using different sets of assumptions, 1983 NYSE average daily share volume is projected at somewhere between 91 and 115 million shares.

Introduction

This paper breaks down commission revenues between institutional and individual investors and estimates the market share of full service firms versus discount brokers. It discusses the impact of commission rate discounting on trading activity, forecasts the growth of discount brokers, and makes projections concerning possible reactions by the securities industry to greater banking involvement in the agency securities business. The paper concludes with a brief discussion of the determinants of trading volume and stock price levels prior to presenting an estimate of 1983 NYSE volume along with full service firm commission revenues.

The Banking-Discount Brokerage Alliance

Legislation permitting full scale financial deregulation appears unlikely anytime soon. However, there is an increasing movement by financial institutions into the gray inter-industry areas not clearly defined or envisioned by past legislation. BankAmerica's bid to purchase Charles Schwab, and the recent approval by the Comptroller of the Currency allowing Security Pacific to create its own discount brokerage subsidiary, are typical of such actions which may be challenged in the courts because of concern that they undermine the intent of the Glass-Steagall Act.

Regardless of how the question of direct ownership is resolved, hundreds of banks and savings and loan institutions may be offering discount brokerage services to their customers through legally acceptable affiliations with non-owned discounters within the next few years. This will occur because of the competitive need to match the discount brokerage services that a number of banks and thrifts are already offering, and to help prepare for what some perceive will be a closer link between banking activities and brokerage functions in future years.

This new channel for the purchase of equities may not only be widely available but could also be heavily promoted. To assess how much market share might be taken away from the full service brokerage firms and the impact that a heightened commission cost consciousness might have on existing commission revenues, it is helpful to look at the securities industry's experience since the elimination of fixed commission rates on May 1, 1975.

Based on Table 1 below, I calculate that in 1980 the full service brokerage firms traded approximately $700 billion in listed securities on registered exchanges. The roughly 26-28 million orders for individuals were handled at an estimated charge of 1.24% of the dollar value of securities processed, and the approximately 1.2 to 1.4 million institutional transactions were done at a cost of about 0.35% of the principal value. The

difference in commissions charged retail versus institutional investors arises, in part, from the number of shares per trade. For example, an average retail transaction in 1H 1982 might have approximated 325 shares, and at 27.7¢ per share, such an order would generate commissions of roughly $90. An average institutional block transaction in 1H 1982 consisted of 26,000 shares, and at 8.9¢ per share, generates a commission of $2,314 per ticket.

Table 1

ESTIMATE OF LISTED EQUITY COMMISSIONS RECEIVED BY FULL SERVICE FIRMS FOR TRANSACTIONS ON REGISTERED EXCHANGES

(excludes business executed through discount brokerage firms)

	1974	1976	1979	1980	1981	1H 1982 (annualized)
Listed Shares Bought and Sold for the Public on Registered Exchanges						
	(MM)	(MM)	(MM)	(MM)	(MM)	(MM)
Individual	3011(41.1%)	4527(41.9%)	5490(34.9%)	7171(32.7%)	6799(30.4%)	5868(24.2%)
Institutional	4315(58.9%)	6265(58.1%)	10253(65.1%)	14774(67.3%)	15602(69.6%)	18404(75.8%)
Total	7326(100%)	10792(100%)	15743(100%)	21945(100%)	22401(100%)	24272(100%)
Average Commission Paid Per Share to Full Service Firms						
	(¢)	(¢)	(¢)	(¢)	(¢)	(¢)
Individual	31.9	30.9	32.7	33.1	31.5	27.7
Institutional	26.0	18.0	12.0	11.5	10.5	8.9
Commission Revenues From Executing Listed Securities on Registered Exchanges						
	($MM)	($MM)	($MM)	($MM)	($MM)	($MM)
Individual	959(46.1%)	1398(55.3%)	1797(59.4%)	2372(58.2%)	2144(56.7%)	1624(49.8%)
Institutional	1122(53.9%)	1128(44.7%)	1230(40.6%)	1702(41.8%)	1638(43.3%)	1638(50.2%)
Total	2081(100%)	2526(100%)	3027(100%)	4074(100%)	3782(100%)	3262(100%)

Note: The above table provides an approximation of the actual experience of the full service firms. It is derived from SEC and NYSE data and by necessity includes some assumptions and estimates. The securities industry may have been classifying small institutional trades as retail trades in reports to the SEC, thus, lowering the SEC's average cents per share figures for both institutional and retail transactions.

Block Trading

The decline in cents per share paid by institutions has been importantly influenced by the growth of large block transactions.

Table 2

Year	Block Transactions as % of NYSE Reported Volume (Blocks of 10,000+ shares)
1974	15.6%
1976	18.7
1979	26.5
1980	29.2
1981	31.8
1H 1982	39.9

While part of the increase in institutional activity and member firm trading is options related, the increase in block transactions has clearly been a key factor in the growth of institutional trading. I estimate roughly that block transactions have grown from around 26-28% of total institutional volume in 1974 to around 45-50% in the first half of 1982.

Why Institutions Are Trading More Actively

In 1980, I calculate that individuals turned their portfolios over by an average of about 11%, while the institutions in the SEC's survey were experiencing a turnover of about 40%. There are several explanations why institutions trade more actively than individuals. Tax considerations, which are a major trading inhibitor for many individual investors, are not a deterrent for most institutions, since many institutional short-term stock gains are either taxed at low rates or not at all. The growth of investable assets is often mentioned. According to SEC figures, between 1974 and 1980, the market value of institutional stockholdings rose from $236 million to $498 million, an increase of 111%. Of that increase, 52% can be accounted for by the growth of the NYSE common stock index. During the same period, M-2, which is a rough proxy for the growth of individual financial assets, rose 82%. Thus, individuals probably had as much of a relative increase in investible funds as institutions. Therefore, the much greater proportional increase in institutional trading is, in my opinion, unrelated to the growth of investable assets.

Another consideration which did have an influence was the mandate by institutions to invest in stocks during a period when inflation was rising faster than equity prices. In order to generate an acceptable rate of return from funds invested in

common stocks, many portfolio managers adopted a strategy of taking numerous small profits hoping for a greater return than simply holding selected securities. Thus, performance pressures created a desire to trade more actively, and the lower commission rates per share, as a result of trading in blocks, permitted such a strategy.

Table 3

COMMISSION RATES AND INSTITUTIONAL TURNOVER

	1974	1976	1977	1978	1979	1980	1981
¢/share paid by institutions	26.0	18.0	15.0	12.5	12.0	11.5	10.5
Turnover rate of selected institutions	21.1	23.3	22.9	29.0	29.8	42.8	39.3(est)

The SEC's method of calculation was revised in 1979 and the figures prior to that year reflect my adjustment based on the difference between the 1979 figure as reported under the old method and the 1979 figure as presented using the revised method.

The data in Table 3 suggests that lowered transaction costs resulted in a dramatic increase in institutional stock volume. Commission costs for institutional trading have decreased to the point where there is little reason to use a discount broker. One knowledgeable industry source estimates that less than 5% of discount firms' listed commissions are generated by institutions. It seems unlikely that the infusion of capital that a large depository institution could bring to a discount brokerage subsidiary would necessarily enable it to penetrate the institutional market. Since hundreds of depository institutions may be competing for the discount brokerage business within several years, it is doubtful that any one discount firm will have sufficient order flow to participate substantially in institutional activity, especially without an expensive research effort, a large number of sales-traders, and experience in allocating and hedging risk capital. While institutional revenues of the full service firms seem likely to be unaffected by banking industry sponsorship of discount brokerage in the next few years, the retail business may be more vulnerable to erosion.

Full Service Firms Hold the Line on Retail Commissions

Since 1980, I estimate the large full service firms have experienced only a slight increase in discounts from posted prices. Every calculation I have ever done indicates that on a fully costed basis, the average retail ticket of $90 in commissions does not cover the associated expenses for the full

line firms. This is especially true during bear markets when the volume of retail transactions declines. Throughout the bear market of mid-1981 through mid-1982, the industry continued to expand its capabilities, capacity, and therefore expenses. Despite a decline in overall individual commissions of 32%, when comparing 1H 1982 with 1980, the number of registered representatives increased from 45,700 at the beginning of 1980 to 53,600 by the start of 1982. Since one industry official estimates that it now costs $20,000 for a full service firm to put an additional registered representative behind a new desk, the securities industry may have added as much as $160 million to its overhead during the bear market.

By my estimate, the decline in average cents per share realized on retail transactions from 33.1¢ in 1980 to 27.7¢ in 1H 1982 has little to do with increased discounting. Commission rates are generally structured so that as stock prices decrease, the cents per share charge also decreases, while as the number of shares per transaction increases, the cents per share charge decreases. The average retail customer has continued to invest about the same dollar amount per transaction over the past few years. Thus, as the average price of a stock declined, it resulted in an increase in the number of shares per order. Between 1980 and 1H 1982, when the average price per share traded on the NYSE declined about 15%, the average shares traded per retail order rose roughly 25%. Thus, the decline of 5¢ per share realized by the full service firms from 1980 to 1H 1982 can be accounted for, according to my calculations, almost entirely by the decline in average share price and the increase in number of shares per transaction. This suggests that as stock prices rise, cents per share realizations will increase, perhaps significantly.

The Rise in the Discount Brokerage Industry

The price paid by the full service firms for holding the line on individual commissions has been an increasing market share attracted by the discount brokers. The growing loss of retail orders has not only deprived the full service firms of commission revenues, but has perhaps more importantly, meant a loss of net interest income from the accompanying margin account balances.

Table 4

ESTIMATED GROWTH OF THE DISCOUNT BROKERAGE INDUSTRY

	1976	1979	1980	1981	1H 1982 (est)
Listed share commissions ($MM)	24	98	154	171	129
Market share of all listed individual commissions executed on registered exchanges	1.7%	5.2%	6.1%	7.4%	8%
Market share of all listed shares traded by individuals assuming discount commissions average 55% of full service rates	3%	8.8%	10.3%	12.3%	13.2%

Since cutting prices is one of the most powerful of all marketing appeals, it is important to reflect upon why discounting hasn't become more prevalent. One possible explanation is that in return for an estimated savings of roughly 1/8 of a point per share, the customer is giving up access to much of the market information, research, investment guidance, tax advice, and personal service that a registered representative of a full service firm provides. Another reason is that the broker often is the one who initiates the transaction. Individuals also tend to focus more on the price of the security and its fluctuation than on the commission charge. Finally, many active traders with large acounts are already being accommodated by full service brokers, thereby reducing their incentive to utilize discounters.

Depository Institutions Sponsor Low Cost Services for Equity Investors

Enter the banks and the savings and loan institutions, whose discount affiliates may aggressively promote their services to bank customers over the next few years. Although discount brokerage customers presently have the security of being covered by SIPC and the convenience of dialing a WATS number, the added prestige, local convenience, and broad customer base may enable banks to attract securities investors. If permitted ownership, the banks may also provide capital for the expansion of the discount brokerage industry in the form of new offices, new services and added margin carrying capacity. Probably, banking affiliated discounters would eventually dominate the discount brokerage industry.

With hundreds of banks splitting a relatively small amount of revenues and the possibility that the large national discount

brokerage firms may actually lose business in each part of the country to local depository institutions, offering a discount brokerage service could become a money loser for many institutions. Nevertheless, such service may be widely viewed as a competitive requirement to retain existing customers who may be attracted by other financial institutions and a necessity in preparing for any further reduction in barriers between the brokerage and banking industries.

Full Service Firms May React to the Competitive Threat in Different Ways

The likely reaction by most full service firms will be to continue the past strategy of making their customers more appreciative of the services they are receiving. It seems probable that the ability of full service firms to raise commission rate structures to reflect higher processing costs will continue to be hampered.

There is another possibility which could occur if the full service firms feel really threatened. They might adopt a fully discounted commission structure, eliminating the raison d'etre for discount brokers and at the same time, may stimulate individual equity volume. Individuals who trade stocks often (and this is by far the most important listed equity customer for the full service firms) may do so more frequently if commission rates were reduced under the right circumstances. Full service firms' willingness to try such a bold step will be a function of their profitability, the degree of their market share loss, and reductions in individual tax rates and the capital gains holding period. A key factor influencing the course of events will be the securities industry's ability to significantly reduce its order handling cost.

If the banking industry is successful in attracting listed equity customers through a strategy emphasizing commission savings, the securities brokerage industry is likely to perceive this as a very significant threat to the traditional heart of its business. One likely counter-reaction might be to more aggressively develop and expand their deposit taking and lending abilities. Already full service brokers have close to $100 billion deposited in money market funds and the industry-wide trend to emulate CMA accounts is now well underway. Expanded intermediary lending in the form of first and second mortgage packages, guaranteed corporate commercial paper rates, commercial and government projects financed through unit trusts, or institutionally financed corporate bridge loans are only some of the many products that the full service firms might emphasize even more. In other words, a successful merger between banking and discount brokerage seems likely to further break down the barriers between banking and the securities business.

What Determines Trading Volume

My projection of future commission revenues takes into consideration the following influences on equity transaction activity.

Public Trading Volume Determinants

1) The number of shares available for trading
2) The direction and rapidity of movement of stock prices
3) Capital gains tax rates and holding periods
4) Uncertainty about the future
5) Option-related activity
6) Institutional performance pressures
7) Transaction costs
8) Ability to buy or sell positions quickly and in an orderly manner

Up until 1977, NYSE average daily volume correlated very highly, over time, with the number of shares listed. As a result of stock splits, new listings, and issuance of additional shares by listed companies, shares listed increased on average about 9-10% annually. When stock prices decline, shares available for trading tend to grow at a lower rate (6-7% annually), and when stock prices rise, the growth in shares listed tends to accelerate (12-14% annually). Given a specific level of shares listed, there is a definable level of share turnover -- the expected volume. Actual volume fluctuates around expected volume depending upon the degree and direction of stock price movements. For example, if stock prices decline 30% over a twelve month period, then actual volume might be about 80 to 95% of expected volume. If stock prices rise 20 to 25% a year, actual volume, roughly speaking, might average around 115 to 130% of expected volume. When stock prices rise 40 to 100% annually, actual volume might run about 140 to 150% of expected volume.

When a bear market ends and the market reverses direction, it is theoretically possible for actual volume to jump from 80% of expected levels to 150% of expected volume very quickly. Calculations suggest that during the recent August volume surge, institutional activity picked up about 90% from first half 1982 levels.

Although tax considerations are not an investment concern for many portfolio managers, they are for most retail investors. Individual tax rates are coming down further and passage of a six-month capital gains holding period, which seems likely in the near future, should have a significant positive impact on the desire to own stocks as well as on the frequency of investment turnover.

Volume is also a function of the level of uncertainty and consequent disagreement between buyers and sellers of stock, as well as their disparate needs. Fortunately for brokers, many people spend much of their lives living with economic uncertainty. Furthermore, the growth of options-related stock transactions has raised the overall level of activity for both institutional and retail investors. There are technical influences on overall volume as well. For example, at turning or breakout points in a market, volume levels also pick up, just as they do for individual stocks.

Two Projections of 1983 Listed Commission Revenues

I assume in both projections that listed equity trading volume during the first half of 1982 actually reflected bear market levels and that portfolio managers' desire to trade actively and the proportion of options-facilitated transactions will continue well into 1983. In Projection A, I assume that actual volume is 120% of expected volume for both individual and institutional investors, that discount brokerage firms account for 16% of individual transactions, and that full service firm discounting from posted rates is little changed from 1982. In Projection B, I assume that actual volume is 150% of expected volume, that discount brokerage firms attract 20% of individual transactions, and that full service firms discount somewhat more from average posted prices, which increase significantly because of much higher average stock prices with no change in average order size. In both projections, I assume member firm trading on all registered exchanges averages 27% of total volume, that shares listed increase 10% over the next 12 months, and that a six month capital gains holding period is adopted in 1983.

Table 5

PROJECTED 1983 LISTED EQUITY COMMISSION REVENUES FOR FULL SERVICE FIRMS

	Assumptions A	Assumptions B
Public shares bought and sold on registered exchanges:		
	(MM)	(MM)
Individual	11,273(27.1%)	14,762(28.0%)
Institutional	30,367(72.9%)	37,958(72.0%)
Total	41,640(100%)	52,720(100%)
Average commission paid per share to full service firms:		
Individual	30.7¢	34.8¢
Institutional	9.0¢	9.0¢
Total $ commission revenues from executing listed securities on registered exchanges:		
	($MM)	($MM)
Individual	3,382(55.3%)	5,019(59.5%)
Institutional	2,733(44.7%)	3,416(40.5%)
Total	6,115(100%)	8,435(100%)
Average daily shares traded on the NYSE:		
	(MM)	(MM)
	91	115

My calculations suggest that in a bull market, 1983 listed equity commissions executed on registered exchanges might increase by as much as 87% to 158% over industry levels achieved in the first half of 1982 (institutional commissions would jump by 67% to 108%, while retail commissions would soar by 108% to 209%). It also suggests that the unprecedented level of volume lately may not be an aberration, but could be indicative of the sustained level of trading volume during a bull market. If and when the stock market breaks out above its 17 year trading range (above 1060 Dow), NYSE volume may average as much as 150 million shares per day for several months at the beginning of the move. The industry should be prepared for such a possibility as early as the first quarter of 1983.

The above figures are only estimates based on the analysis and assumptions presented in this report, and may differ substantially from actual 1983 experience, especially if my assumptions about real GNP growth or the pace of financial deregulation prove incorrect.

Joel Rosenthal, Vice President
Jesup & Lamont Securities Co., Inc.

SECURITIES INDUSTRY STATISTICS

VOLUME

	SEPTEMBER 1982	YEAR-TO-DATE 1982	SEPTEMBER 1981	YEAR-TO-DATE 1981	% CHG. Y-T-D 1982-1981
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	73.7	57.2	45.7	47.1	21.4%
AMEX (MILS.)*	5.1	4.4	5.5	5.5	(20.0)
NASDAQ (MILS.)*	35.1	28.4	28.0	31.2	(9.0)
REGIONAL EXCHANGE (MILS.)*	10.7	8.0	6.1	6.1	31.1
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	46,782**	307,192	28,003	299,632	2.5
AMEX (MILS.)	1,322	9,988	1,871	19,245	(48.1)
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	5,037	42,157	4,670	48,217	(12.6)
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	15,031	93,976	9,022	103,275	(9.0)
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	42.5	40.9	30.4	31.2	31.1
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	7,074	52,586	5,803	40,907	28.6
AMEX OPTIONS	3,577	26,255	3,233	25,153	4.4
COMMODITY	9,783	82,165	8,591	68,630	19.7

* *MONTHLY AVERAGE*

** New High

YIELDS

(MONTHLY AVERAGES)

	OCTOBER 1982	OCTOBER 1981	BASIS POINT CHANGE
BOND BUYER INDEX (20 BOND)	9.69	12.83	(3.14)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	12.12	15.40	(3.28)
Baa CORPORATE	14.73	17.11	(2.38)
RATIO Aaa CORPS. TO Baa CORPS.	0.82	0.90	(0.08)
MUNICIPAL BOND YIELDS (MOODY'S)	8.94	12.05	(3.11)

PRICES

(END OF MONTH)

	OCTOBER 1982	OCTOBER 1981	% CHANGE Oct. '82 - Oct. '81
DOW JONES INDUSTRIALS	991.72	852.55	16.3
STANDARD & POOR'S 500	133.71	121.89	9.7
NYSE COMPOSITE	76.95	70.64	8.9
AMEX MARKET VALUE INDEX	319.82	312.02	2.5
VALUE LINE COMPOSITE	148.42	137.42	8.0
NASDAQ COMPOSITE	212.63	195.24	8.9

UNDERWRITING
(DOLLARS IN MILLIONS)

	OCTOBER 1982	Yr.-to-Date 1982	OCTOBER 1981	Yr.-to-Date 1981	% Change October 1982 October 1981	% Change Yr.-to-Date
CORPORATE FINANCING (Gross New Issues)						
Total	9,689	57,942	3,665	47,405	164.4%	22.2%
Competitive	471	2,737	405	4,062	16.3	(32.6)
Negotiated	9,218	55,205	3,650	43,674	152.5	26.4
Common Stock	1,794	10,515	717	12,995	150.2	(19.1)
# Of Common Stock Issues	58	475	63	776	(7.9)	(38.8)
Preferred Stock	715	4,256	125	1,437	472.0	196.2
# Of Preferred Stock Issues	7	65	3	35	133.3	85.7
Corporate Debt	7,180	43,172	2,822	32,972	154.4	30.9
# Of Corporate Debt Issues	84	471	30	349	180.0	35.0
MUNICIPAL FINANCING* (Gross New Issues)						
Total	11,281	93,783	7,168	64,441	57.4	45.5
Notes	3,283	36,556	3,543	29,273	(7.3)	24.9
Bonds	7,998	57,228	3,625	36,027	120.6	58.8
# of Bond Issues	430	4,227	283	3,458	51.9	22.2
Negotiated Bonds	5,158	39,168	2,602	22,288	98.2	75.7
Revenue Bonds	5,485	39,213	2,772	24,450	97.9	60.4

*Preliminary Figures

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	SEPTEMBER 1982	Year-to-Date 1982	SEPTEMBER 1981	Year-to-Date 1981	% Change, Y-T-D '82 to Y T D '81
NET SALES*	265.8	3067.2	41.0	946.0	224.2%
NET PURCHASE OF COMMON STOCK*	289.8	697.0	(133.8)	(237.8)	(193.1)
NET PURCHASE OF OTHER SECURITIES*	N.A.**	N.A.	N.A.	N.A.	N.A.
MUTUAL FUND CASH POSITION	9.7	----	11.4	----	----

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS
** Data not available for this period

MARGIN DEBT

	SEPTEMBER 1982	SEPTEMBER 1981	% Change Sept. '82-Sept. '81
MARGIN DEBT OUTSTANDING ($MILS)	10,950	13,760	20.4%
NET CHANGE IN MARGIN DEBT ($MILS)	(2,810)	1,240	-----
% OF ACCOUNTS WITH EQUITY UNDER 40%	9	16	-----

* ALL TIME HIGH

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	THIRD QUARTER 1982	Yr.-to-Date 1982	THIRD QUARTER 1981	Yr.-to-Date 1982	% Change 3rd Q. 1982 3rd Q. 1981	% Change Yr.-to-Date 1982-1981
REVENUE						
SECURITIES COMMISSION INCOME	1,479	3,751	1,222	4,078	21.0%	(8.0%)
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	1,786	4,156	822	3,250	117.3	27.9
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	595	1,391	323	1,167	84.2	19.2
TOTAL REVENUE	5,903	15,391	4,524	14,356	30.5	7.2
TOTAL EXPENSES	4,933	13,960	4,300	12,835	14.7	8.8
NET INCOME BEFORE TAXES	970	1,431	224	1,521	333.0	(5.9)
PERCENT OF FIRMS SHOWING LOSS	16.0%	32.2%	45.4%	25.8%	----	----

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
"Review of TEFRA Regulations Issued December 15, 1982"	A summary which highlights three sections of the temporary and proposed rules contained in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) affecting the securities industry. The purpose of the summary is to alert industry of the upcoming demands it will face under the new law, in order to focus better on strategies for implementation. Withholding on Interest and Dividends, Information Returns of Brokers, and Information Reporting with Respect to Interest and Original Issue Discount are examined.	Research Department Securities Industry Assoc 120 Broadway - 35th Floor New York, New York 10271
"SEC Staff Report on the Securities Industry in 1981"	The fifth in an annual series of SEC reports on the securities industry's earnings experience. Emphasis is placed on the volatile market conditions prevalent during 1981, in recognition of the industry's growing dependence on the principal business. Of particular interest is the SEC's attempt to estimate the industry's total interest income from all sources. The financial data on different classes of broker/dealers, also, are especially useful.	A report of the Staff of the U.S. Securities and Exchange Commission October, 1982
"The Financial Services Industry of Tomorrow"	The report of a committee which the NASD assembled to assess the regulatory, economic, and technological evolution taking place in the financial services industry. The implciations of this evolution for the management of securities firms, both large and small, are the report's primary focus. Prompted by the startling series of mergers which took place during 1981, the study stresses that financial deregulation has already, in large measure, taken place, despite the lack of legislative clarification. It confronts the "level playing field"	Order from: National Association of Securities Dealers Inc. 1735 K Street, N.W. Washington, D.C. 20006

ITEM	DESCRIPTION	SOURCE
	question, arguing for regulation by function to replace the regulation by type of institution which has become an anachronism. The "financial supermarket" aspirations of various conglomerates are examined and contrasted with the market success of numerous small specialty shops, many of which are recent entrants into the business. Technological advances and related changes in the provision of retail financial services are also considered in some detail.	
"Inside an Innovative Financing"	A discussion of debt/equity swaps containing useful data on volume, underwriter rankings, etc. The debt/equity swaps result from a provision of 1981 tax legislation that treats a corporation's gain from the repurchase of its own debt outstanding as taxable income. This same legislation classifies an exchange of stock for bonds as a (non-taxable) recapitalization while allowing the corporation to report the resultant gain in the current period's earnings. These swaps are eloquent testimony both to the ingenuity of investment bankers and to the devastating impact of inflation on fixed income portfolios.	Investment Dealers' Digest November 16, 1982
"Crash of "82, Kuwait-Style"	A highly readable account of the recent upheavals in Kuwait's Gulfshore market. This market runup, in which stocks themselves had become a sort of forward or futures contract, collapsed in September. The usual elements of speculative fever are complicated and magnified by Kuwait's unique affluence. Repercussions could be worldwide if the Kuwaiti government increases the nation's oil output to finance some limited bail-out.	Barron's November 22, 1982

BEST AVAILABLE COPY

Securities Industry Trends

ANNUAL SUBSCRIPTION
$24.00 member • $39.00 non-member

AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

Vol. IX No. 1 March 4, 1983

A8825-1
3/15/83

A PRIMER ON DISCOUNT BROKERAGE

HIGHLIGHTS

1. Since Mayday, broker/dealers in general have instituted pricing policies favoring institutions over individuals. This, with a marked lack of unbundling, created the climate in which discounters could offer unbundled execution at rates roughly 40%-70% off the April 1975 fixed level.

2. Discounters engage in a head-on, if somewhat one-way, competition against national full-line firms. Their advertising, the core of their sales effort, stresses the comparative level of commission charges. The most basic difference between the two groups is the lack, among discount brokers, of the RR-client tie.

3. In 1982, NYSE discounters were nearly three times as commission-dependent (63% of gross) as were all firms dealing with the public. This lack of diversification, and a higher ratio of fixed to total costs, gives the discounters higher than average earnings volatility, despite their low profile in principal activities.

4. We estimate discounters' market share of 1982 retail commissions at 8.4%, up from 6.3% in 1981. In return on equity, too, discount brokers outperformed the total industry in 1979 and 1980 but trailed the industry in 1981 and 1982.

5. Despite this profitability and growth, some questions remain. Discounters' share of industry 1982 gross revenues -- 1.8% -- was below the 1980 level of 2.1%. Retail brokerage, quite simply, has been a slow-growth area for years. Some full service firms appear resigned, strategically, to losing retail customers whose relationship is strictly transactional, opting to concentrate instead on faster-growth, higher margin areas.

6. The advent of bank and thrift discounters -- 600-strong by December 1982 -- seems bound to alter this business greatly. Regulatory ambiguities notwithstanding, the banks and thrifts will erode the market share of existing discount brokers.

Securities Industry Association
120 Broadway • New York, N.Y. 10271 • (212) 425-2700

Introduction[1/]

In recent months, there probably has been no subject discussed more widely in the financial press with less supporting documentation than trends in discount brokerage. Now with commercial banks both forming their own discount brokerage subsidiaries and purchasing independent discount brokers along with thrifts entering the brokerage business, the lack of good, reliable data on discount brokerage sticks out like a sore thumb. According to a recent Fortune article, not a single major bank in the U.S. offered discount brokerage services at the beginning of 1982.[2/] By year-end, almost 600 banks and thrifts had announced plans to enter that business with the number expanding daily.

Despite a smattering of data based on quotes from individuals running discount brokerage houses, the only previous attempt to estimate the growth of discount brokers and their market share appeared in various issues of the SEC's annual staff report on the securities industry. Unfortunately, the SEC's efforts in this area stopped with 1980 data. Because of the vast changes now taking place in the ownership of discount brokers, we thought it important to pick up the slack by preparing a paper discussing major trends in discount brokerage and updating figures for the revenues, profits, and market share of discounters relative to the securities industry in general as well as specific segments of the industry.

The numbers published in this study were made available through the cooperation of the NYSE and NASD. Nevertheless, assumptions were still necessary in deriving estimates of retail commissions and the market share of discount brokers. To provide an historical trend on the market share of discount brokers, we utilized the methodology employed by the SEC in deriving their estimates for 1977 through 1980. This is important to keep in mind not so much for focusing on the figures, but rather for retaining some perspective on the likely overall trends as far as discount brokerage is concerned. Naturally, the most reliable data contained in this paper are those for which no estimates were required, figures derived from FOCUS Reports submitted to the self-regulators.

1/ This paper is based in part on a forthcoming article appearing in the American Bar Association Journal entitled "Have Discount Brokers Topped Out?" That paper was prepared by Jeffrey M. Schaefer and lacked some of the data now available in this document. Our thanks go to the publishers of the American Bar Association Journal for their cooperation in allowing us to expand the original paper into a more detailed discussion of trends in the discount brokerage industry.

2/ "The Banks Invade Wall Street," Fortune, February 7, 1983.

Frankly, the estimating techniques and other assumptions involved in reaching certain conclusions are difficult enough as is. The problems will become more rather than less troublesome in the future. As thrifts and commercial banks offer discount brokerage by "networking" through other entities, it will be impossible to observe these numbers relative to business done directly through a broker/dealer subsidiary. For the benefit of all those who monitor developments in the overall brokerage business as well as in discount brokerage, including the regulators and self-regulators of financial intermediaries, this problem should be grappled with immediately rather than at some time in the distant future.

May 1, 1975 (Mayday)

In the 1970's, the U.S. securities industry underwent significant changes in structure, concentration, and diversification of revenue sources. Most of these changes resulted from economic forces which were driving up prices and interest rates. This, in turn, led to dramatic changes in the demand for services and products provided by the securities industry. Until 1978, there was a sharp decline in the number of securities firms dealing with the public, increasing concentration (the market share of the largest 10 and 25 firms increased noticeably), and a deemphasis on commission business. With the sharp increase in market volume since 1977, some, but not all, of these trends have moderated. While concentration continued to increase and commission revenues declined in relative importance, the number of firms doing a public business stopped falling and even increased slightly.

Some, but not all, of these trends were intensified by the SEC's decision to eliminate fixed commission rates on May 1, 1975. This regulatory change reduced the profitability of the institutional brokerage business as institutional rates quickly plunged from their pre-Mayday levels.

The demise of institutional research houses was swift and striking. As the debate over fixed rates was proceeding, general predictions had been made concerning four likely consequences of commission rate deregulation. These were: 1) market fragmentation, 2) attrition in the securities business, 3) pricing policies more favorable to institutions than to individuals, and 4) unbundling of services. The market fragmentation prediction proved totally incorrect. The third market was an early casualty of Mayday, and the NYSE's share of listed trading rose markedly after fixed rates were eliminated. There was unquestionably a decimation of the brokerage house ranks following Mayday, but it was more confined to the institutional sector than had been anticipated. Retail firms did encounter difficulties in 1977, but these problems stemmed more from poor markets than from the advent of competitive rates.

The extent to which predictions 3) and 4) have been fulfilled has created the climate in which discount brokers operate. A two-tiered commission rate structure was fully in place by 1977. Anti-trust considerations have made it difficult for SIA to survey member firms' commission charges since April 1975, but we believe that, on average, institutional trades, on a cents per share basis, are priced at roughly one-third the rate charged retail investors.3/ The full service firms have resisted most pressures for retail discounting, and surprisingly little unbundling has occurred.

In the institutional sphere, proprietary trading is viewed as an independent profit center, in no conceivable sense as an adjunct to institutional brokerage as it once was. Hard-dollar research revenues remain negligible, while there appears still to be adequate research coverage of both companies and markets. Liquidity and research were the most important soft-dollar services in the pre-Mayday business. They are also services which discount brokers, by and large, do not offer.

The unfixing of commission rates allowed for a new competitive strategy to be employed in offering retail brokerage services. Some new firms entered the industry primarily to attract retail business by offering commission charges well below prices of more established firms. Others already in the business as traders and market-makers or specialist firms became discounters. Such firms used discount brokerage as an opportunity to augment their other operations. Few, if any, of the largest, well-established firms chose to operate solely as a discount broker in terms of market strategy.

For discussion purposes, it is useful to define precisely what is meant by the term "discount broker." Discounters operate almost entirely in the retail business; institutional investors, conscious of both their market power and fiduciary obligations, invariably demand (and get) from full service firms execution at rates well below those that prevailed in April 1975. A "pure" discounter offers only execution, although a variety of services can be found in the discounter field, as discussed below. This discounter execution service is usually offered at a discount of roughly 40%-70% off the April 1975 fixed rate level. Discounters are distinguished, too, by their lack of an active sales force, which creates an emphasis upon mass media advertising and execution of unsolicited orders. This sales technique is clearly more effective in the brokerage than in the investment banking business and has, therefore, troublesome Glass-Steagall implications. Execution of unsolicited orders, which is, in effect, waiting by the telephone for orders, would be a weak primary market strategy.

3/ Joel Rosenthal, "The Impact of Banking Industry Sponsorship of Discount Brokerage Firms on the Securities Industry," Securities Industry Trends, December 6, 1982, p. 3.

The essence of primary market success is the ability to move large quantities of stock or bonds into investor hands as quickly as possible.

Actually, discount brokerage existed prior to Mayday but the opportunities were very limited. Prior to 1975, broker-dealers discounting commissions on brokerage transactions for retail customers were limited to offering discounts from fixed rates on over-the-counter (OTC) trades or operating as agents between clients and "third market" dealers (firms making markets in listed stocks who were not members of exchanges). The elimination of fixed rates on May 1, 1975 expanded opportunities for discount brokers considerably by making it possible for exchange members to offer discounted commission rates on transactions in exchange-listed stocks and by enabling non-member brokers to negotiate access to exchanges at lower rates.

Full-Line Firms and Discount Brokers

It is impossible to discuss discount brokers without touching on overall developments in the securities industry. This is necessary because pronounced market developments, whether bullish or bearish, affect similarly securities firms emphasizing different market strategies. Moreover, discounters compete directly with full-line firms (and regional firms) for retail customers. This latter point is clear from promotional material generated by discounters comparing the prices charged by full-line firms and that available from discount brokers. It is acknowledged that there is a substantial overlap between the customers of discount brokers and full-line firms. This creates a situation whereby some investors are believed to execute through a discounter transactions that are based on the recommendations of other firms offering comprehensive research services.

Full-line firms typically offer the widest range of customer services and generally charge a commission covering execution, advice, research, custody, and other services that may be involved. As noted earlier, discounters charge commissions below prevailing rates and usually offer fewer services while emphasizing commission savings to the customer. Most of the time, investment advice is not available. However, even within the discount brokerage segment of the industry, wide differences exist in the commissions charged customers and the services made available. Some have chosen to emphasize "bare bones" execution and rock bottom prices. Other discounters have moved closer to the range of services offered by full-line firms in seeking a special market niche for themselves.

The most basic question one can ask concerning discount brokerage is why an investor selling a quantity of stock, given the chance to sell through a discounter at rock-bottom rates, should elect instead to utilize a full service firm charging perhaps two and a half times as much for what is arguably the same service.

Some perceived difference in the service provided by the two is the likeliest explanation. It is sometimes suggested that a difference exists in quality of execution, but the nature of discounters' order flow, with its high proportion of round lots of highly liquid, NYSE stocks, makes it hard to compare execution or, for that matter, processing capacities. The ready availability of clearance services further suggests that this is not the issue. The full service firm's most conspicuous value added is the retail RR's investment advice and sense of market timing. The RR-client tie is one of the great imponderables of the retail brokerage business, and the quality of the investment decision surpasses in importance the level of transaction costs. A recent SIA sales survey revealed that 67% of the RRs in the sample succeeded in bringing at least three-fourths of their accounts with them upon moving from one firm to another. In this respect, discounters and full service firms are at the ends of a continuum, at one end of which the customer is loyal to an institution and, at the other end, to a salesman. Many of the features of asset management accounts, in particular the availability of various forms of credit, have been consciously designed to bind retail customers more closely to a firm. This question of institutional loyalty acquires a whole new meaning as a result of the depository institutions' onslaught upon discount brokerage.

The presence of discount brokers has affected the competitive strategy of full-line firms. Full service firms provide discounts to their more active retail customers, but they do not disclose their policies on such discounts or even publicize the normal commission rates they charge. However, since Mayday, full-line firms have increased prices to most of their retail customers and have chosen to compete aggressively on the basis of service and the range of products offered.4/

Profitability and Business Mix

According to available SEC figures, there has beer an impressive growth in the number of discount brokers and in their market share. However, these trends should not be considered apart from developments in the overall securities industry. Since Mayday, the securities industry has enjoyed some highly profitable years. Indeed, record earnings and return on equity (ROE) were achieved in 1980. Except for 1977, and the fourth quarter of 1978, all segments of the industry have enjoyed a prosperous cycle. Despite last year's inauspicious beginnings, 1982 figures, when released, will show record profits.

4/ According to a recent advertisement in Registered Representative, the average retail commission rate has increased 26% since Mayday. See the February, 1983 issue.

This had led to more firms entering the industry, particularly smaller boutique-type operations emphasizing specialized products to specific customers, and to a continuous trend away from the equity agency business. For example, while commissions accounted for 55% of the industry's gross revenues in 1973, this percentage plummeted to 27% in 1981. For the first three quarters of 1982, the percentage fell even further -- below 25%. Given the dramatic market rally ignited in mid-August, the percentage for all of 1982 will probably amount to over 25%, but may well remain below the 27% for 1981. This reduced dependence on commission revenues on the part of the total industry contrasts sharply with the average discount broker. For these firms, almost two-thirds of their gross revenues are attributable to commission revenues (see Table 1).

Table 1

Revenue Breakdown for NYSE Discount Brokers, 9 mos. 1982
(millions of dollars)

	First 9 Mos.*	As a % of Gross	Comparable Nat. Full Line Percentage	Entire Industry
Commissions:				
Listed equities executed on an exchange	$ 90	50.8%	18.5%	18.2%
Listed options	13	7.3	4.6	3.1
All other commissions	10	5.7	2.4	3.1
Total commissions	111	62.7	25.5	24.4
Trading Profits	3	1.7	22.6	25.2
Investment Profits	6	3.4	(0.3)	1.8
Margin Interest	29	16.4	14.3	10.3
Underwriting	2	1.1	11.3	9.0
Commodities	1	0.6	6.5	3.1
Other Revenues Related to the Securities Business	7	4.0	12.9	18.5
Other Revenues Unrelated to the Securities Business	21	11.9	4.1	4.9
All Other	2	1.2	3.1	2.8
Gross Revenues ($ millions)	$177	100.0%	100.0% $6,522	100.0% $15,391
Net Income Before Taxes ($ millions)	$ 17	9.6%	5.3% $ 344	9.3% $ 1,431

* Numbers may not add due to rounding.

Source: FOCUS

From the outset, analysis of discount brokers has been complicated by a scarcity of data. The SEC, for years the main source of data on discounters, announced during 1981 the cancellation of its contemplated discounter study. The SEC Staff Report on the Securities Industry in 1981, released in November 1982, omitted the discounter discussion contained in earlier staff reports. The situation is further complicated by the fact that most discounters do not carry customer accounts, which reduces their quarterly reporting requirements.

SIA, working in cooperation with the NYSE and NASD, hopes to fill this void, a task which may become harder if depository institutions conduct their brokerage business outside of the FOCUS reporting framework. SIA has recently acquired 1982 income statement data for those NYSE firms which the SIA, NYSE, and SEC have classified as discount brokers. These figures, contained in Table 1, provide some useful insights into the current business mix of discount brokers.

Revenues

First of all, it is useful to put the figures for NYSE discount brokers in perspective. Through the first nine months of 1982, their gross revenues amounted to $177 million and their pre-tax net was $17 million. This compares with aggregate revenues of $15.4 billion for all NYSE firms dealing with the public, and pre-tax net of $1.4 billion. In other words, the gross revenues and pre-tax net of discount brokers through the first nine months of 1982 amounted to about 1.2% of that received by all NYSE firms dealing with the public. These percentages are important to keep in mind when analyzing trends in the market share of discount brokers in terms of retail commissions which is often used to determine whether their market share is increasing or decreasing.

The difference in business mix between discount brokers and the wirehouses as well as the overall industry is striking. Clearly, discounters depend far more on commission business than either the industry in general or the wirehouses, their principal competitors. Commissions account for almost two-thirds of their revenues as compared to about one-fourth for the overall industry and even less for wirehouses.5/ Listed options are also relatively more important for the discounters.

Margin lending is an integral part of retail brokerage. The 16.4% of gross figure, while high, understates discounters' involvement in this business, since, for introducing discounters, the margin loan is carried on the books of -- and increases the

---

5/ With the activity in the stock markets accelerating during last year's fourth quarter, these ratios probably rose somewhat for all of 1982.

revenues of -- a correspondent broker. Nevertheless, margin interest revenues are more important for discounters than for wirehouses -- the group which traditionally has the highest ratio of margin interest to gross. The NYSE discounters' involvement in the principal business is predictably low.

From the commission revenue figures, some difference in discounters' order flow is apparent. For the NYSE discounters, commissions on listed equity transactions accounted for 84% of commission revenues, as compared to 73% for the wirehouses. This difference in order flow explains some of the discounters' success in mastering the back office difficulties which were widely noted about three years ago. It is interesting that, while the NYSE discounters have a large options business, their involvement in commodities is minimal. Options and commodities are both investment vehicles of the sophisticated retail investors to whom discounters cater, but options are far more closely related to stock brokerage than are commodities.

The importance of trading profits to the total industry and wirehouses is in stark contrast to the discount brokers' minimal principal commitments. Furthermore, the low level of underwriting revenues for discounters illustrates these firms' low profile in the primary market. The complete lack of investment advisory fees and research revenues (all other) for discounters is consistent with the no frills slant of these firms.

The modest level of other revenues related to the securities business reflects the discounters' lack of institutional customers and corporate financing expertise. Much of the revenue falling into this category derives from the M&A business as well as from the interest earned on matched repos. This latter activity is reported somewhat unreliably, even on FOCUS, with some firms reporting gross interest and others reporting it net. The high proportion of other revenues unrelated to the securities business is, we believe, indicative of the diverse origins of discounters. In other words, they obtain over 10% of their revenues from activities that are, apparently, completely unrelated to the securities business.

Expenses

Table 2 contains detailed expense information for NYSE discounters, wirehouses, and the overall industry.6/ For the discounters, floor brokerage and clearance costs -- the major variable cost faced by discounters -- are far greater relatively than for other segments of the securities industry. At the same

---

6/ The mingling of FOCUS Part II and Part IIA filings in the NYSE discounters' expense data makes some of these comparisons more difficult.

time, their relative costs for compensation to the sales force and administrative and clerical staff are considerably less -- 17% versus 44% of revenue for wirehouses and 33% for the overall industry. Interest expense is also relatively less important, undoubtedly reflecting their lack of involvement in principal activities. At the same time, EDP costs as a percentage of revenues are two or three times what they are for wirehouses and the total industry. This reflects the discounters' commitment to the automated handling and processing of a large volume of transactions. The discounters' order flow, also, lends itself to automated execution, since it consists overwhelmingly of small orders of listed, liquid stocks.

The NYSE discounters' relatively high level of partners' and voting stockholder officers' compensation reveals a very different form of ownership. The "all other expenses" figure -- 22% of the NYSE discounters' gross revenues -- is frustratingly high, undoubtedly bloated with expenses that belong elsewhere in the breakdown. This is a limitation of the existing FOCUS reporting scheme.

Table 2

Expense Breakdown for NYSE Discount Brokers, 9 mos. 1982
(millions of dollars)

	First 9 Mos.	As a % of Gross Revenues	Comparable Nat. Full Line Percentage	Entire Industry
Floor Brokerage & Clearance	$ 25	14.1%	3.3%	3.7%
RR Compensation	12	6.8	24.0	16.4
Clerical & Admin. Salaries	18	10.2	20.3	17.0
Communications	12	6.8	8.6	6.0
Occupancy & Equipment	8	4.5	5.3	4.0
Promotional Costs	6	3.4	3.2	2.3
Error Accounts & Bad Debts	1	0.6	1.2	0.7
Interest Expense	25	14.1	18.0	27.3
EDP Equipment Costs	7	4.0	1.5	1.3
Partners' & Voting Stockholder Officers' Comp.	7	4.0	1.4	3.1
All Other Expenses	39	22.0	7.9	8.9
Total Expenses		90.4%	94.7%	90.7%
($ millions)	$160		$6,176	$13,960

Source: FOCUS

Volatility

The securities industry is among the most volatile sectors of the U.S. economy in terms of quarter-to-quarter profit swings. There is an almost 50-50 probability as to whether, at any given time, the current quarter's profits will be above or below the level of the previous quarter's. In predicting the direction of profit swings from one quarter to the next, the forecaster might as well flip a coin.

As noted earlier, commission revenues and margin interest comprise almost four-fifths of the gross revenues for discounters. At the same time, their costs fluctuate relatively slowly with changes in volume and revenues. This accounts for the impressive operating leverage of discounters, which stands out even in an industry which is noted for its exceptional operating leverage. For discounters, the quarter-to-quarter fluctuation in revenues averaged 23% from the 1Q 1980 through the 3Q 1982. This compares with 13% for the overall industry and 10.5% for national full-line firms. This greater volatility is reflected in more radical swings in pre-tax profit margin, displayed in Table 3. From the beginning of 1980, the absolute average quarterly variation in profit margins for discounters averaged 7.7 percentage points as compared to 4.1 points for the wirehouses and 5.5 percentage points for the overall industry.

Table 3

Pre-Tax Profit Margins

	1980				1981				1982		
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q
All Firms	7.7	19.4	13.8	14.6	13.8	12.8	4.9	11.4	3.7	5.9	16.5
Nat. Full Line	7.5	12.1	10.6	12.8	10.4	9.7	2.0	5.7	(0.4)	2.6	11.8
Discounters (NYSE & NASD)	13.0	8.4	18.2	15.8	7.5	15.1	0.3	3.4	(3.4)	1.8	15.4

Growth of Discount Brokers

Despite the volatility of profits, the discount brokerage industry has grown impressively since May 1, 1975. Unfortunately, the data available from the SEC is limited to 1977-1980. The SEC's analysis was based on FOCUS reports provided by discounters and estimates of aggregate retail commissions. The latter was based on the now discontinued Survey of Commission Charges on

Brokerage Transactions.[7] On the strength of this survey, total commission revenues were allocated between retail and institutional customers.

Although the SEC's published data stopped with 1980, we updated the figures for 1981 and 1982, attempting to maintain the consistency of the series as much as possible so as to depict an historical trend. To our knowledge, there is no other available source or choice. For 1981, the SEC provided us with a commission breakdown that was 65% (retail) and 35% (institutional). For 1982, we used another proxy -- the ratio of "retail" NYSE average daily volume to total average daily volume.[8] With some minor adjustments for activity on other markets, we estimate the retail component of total 1982 commission revenues to have been 58%, a sharp drop-off from the SEC's 1981 estimate of 65%. Blocks of 10,000-plus shares accounted for about 32% of NYSE volume in 1981 and 41% for 1982, and member trading increased in relative importance. We believe our estimate to be in the ballpark with regard both to the historical trend on retail commissions and to the market share of discounters.

Market Share

The growth of discounters has been impressive. Starting with SEC data for 1977, their commissions have grown from $70 million to an estimated $314 million last year (some estimate of the 4Q 1982 was required). For purposes of analysis, it is best to start with 1979, for our data base, provided by the NYSE and NASD, is more consistent from that date onward. If market share is measured by their share of retail commissions, the discounters' penetration has grown from 4.5% in 1979 to a peak of 8.4% last year. If one

---

7/ Initially, the Survey covered 70 securities firms in 1975. By December 1981, the sample included only 21 firms. The decline in coverage was attributable partly to an SEC desire to relieve smaller firms of the reporting burden, partly to mergers or liquidations among the sampled firms. Even so, the 1981 survey comprised 21 firms accounting for 40% of all commission revenues received by firms doing a public business. SEC's Directorate of Economic and Policy Analysis, "Commission Rate Trends, 1975-1981," July 7, 1982, p. 1.

8/ This is derived by subtracting 10,000-share blocks and member trading as a % of NYSE volume. We took the ratio of "retail" volume to total NYSE volume in 1981 and compared that to the breakdown available for the SEC survey -- 65% of total commissions were generated from retail activity and 35% from institutional trading. We assumed that the same ratio would more or less hold for 1982. In other words,

$$\frac{\text{"Retail NYSE activity in 1981"}}{\text{"Retail NYSE activity in 1982"}} : \frac{.65}{x}$$

assumes that discounters charge about half the rate of full service firms, they probably account for about 15% of the retail share volume today, not an insignificant factor.

Table 4

Trends in Market Share of Discounters
(dollar amounts in millions)

	1979	1980	1981	1982
Industry Commissions	$4,513	6,378	6,143	6,454
Estimated Retail Com.	$3,023	4,234	3,987	3,743
Discounters' Commissions	$ 137	237	251	314
Discounters' Market Share of Retail Commissions	4.5%	5.6%	6.3%	8.4%
Industry Gross Revenues	$13,219	18,594	22,631	24,959
Discounters' Gross Rev.	$ 220	389	359	448
Discounters' Market Share of Gross Revenues	1.7%	2.1%	1.6%	1.8%

Previously, papers on discount brokers have emphasized almost exclusively their success in penetrating the retail commission business. Our analysis certainly supports those findings. However, there is another interesting side to the picture. In previous issues, we have noted the decline in the relative importance of the commission business. Broker/dealers have diversified substantially in recent years and have introduced a vast array of new products and services. Thus, although discounters are increasing impressively their market share of retail commissions and share volume, their market share in terms of total securities revenues and activities was virtually unchanged from 1979-1982. For example, their $220 million in total revenues accounted for 1.7% of the industry's gross in 1979. Despite a compounded rate of increase in gross revenues of almost 27% over this period, their share of aggregate industry revenues rose only to 1.8% because the industry's gross was compounding at an annual rate of 24% over the same time period.

In contrast, the compounded annual rate of increase in commission revenues for discounters from 1979-1982 was 32% as compared to less than 13% for the overall industry. Thus, discounters have had a markedly increased impact in the commission business, and particularly in the retail sector thereof. When all is said and done,

however, discounters still account for less than two percent of total revenues because other activities have grown over twice as fast as have commissions. Even within the commission business, institutional revenues have spurted faster than retail.

These figures suggest that some interesting strategic decisions may already have been made. Many securities firms may well have conceded that those business lines and customers lending themselves to a strictly transactional relationship cannot be retained at attractive margins due to the advent of discount brokers. In particular, those discounters now owned by large banks and thrifts, able to promote their services to established captive audiences through flyers included with monthly statements, enjoy a great competitive edge. Thus, securities firms increasingly are shifting their emphasis. Those with strong, active sales forces are looking more and more to the origination and aggressive marketing of new products. These products usually contain greater value-added and, not coincidentally, higher profit margins, allowing for a handsome payout to the account executive and additional profits to the firm.

ROE

Despite the discounters' narrow revenue base relative to other segments of the securities industry, their after-tax return on equity (ROE) has been impressive. Table 5 provides ROE figures for 1979-82 for the overall industry, national full-line firms, and discounters. Since the first half 1982 ROE for the industry

Table 5

After-Tax Return on Equity

	1979	1980	1981	1982*
All Firms	16.1%	26.3%	19.2%	19.2%
National Full Line	13.0	23.8	13.2	13.4
Discounters	21.3	30.1	15.5	15.6

* The 1982 ROE figures are estimates as data for only the first three-quarters are available. Based on the 4Q 1982 results of some of the publicly owned brokerage houses comparing 4Q 1981 to 4Q 1982, we derived estimates for the full year 1982.

was 7.3% and for national full-line firms a paltry 1.8%, the estimates for full year 1982 are truly remarkable and are eloquent testimony to the thunderous market rally under way since mid-August. With fourth quarter 1982 NYSE average daily volume reaching 87.8 million shares, as compared to under 52 million shares during the year's first half, the reader has a good indication of why the industry's profit picture changed so dramatically.

From 1979-1982, the discounters' average annual ROE was almost 21%. This, by itself, makes them an attractive investment vehicle for banks. In addition, banks probably feel they can generate incremental revenues at low cost since their branch network is already in place. Nor should any analysis of banks' motives overlook expectations concerning the future of both the Glass-Steagall and McFadden Acts. Like other intermediaries, banks and thrifts seek to expand the spectrum of retail financial services they can offer. More and more, these evolving financial supermarkets aim to keep their retail customers from going to a competitor for any reason whatsoever.

Conclusion

Competition among all financial intermediaries has increased and focused on providing consumers with packages of financial services that cut across traditional industry lines. A large number of deposit-taking institutions have started to provide brokerage services to customers thorugh their own facilities, or more commonly, through a variety of brokerage firms who handle the execution and clearance for them. The most notable entrant to date into discount brokerage has been the Bank of America, which recently received Federal Reserve approval of its bid to acquire Charles Schwab & Co., which is among the largest, if not the largest, of the discount brokerage firms. Meanwhile, Security Pacific obtained the Comptroller's approval to operate a brokerage subsidiary and soon thereafter acquired Kahn & Co. Other banks soon followed suit acquiring discount brokers while still others began from scratch their own discount brokerage operations.

On the thrift side, the Federal Home Loan Bank Board has approved discount brokerage for its member organizations. Invest, a discount brokerage firm owned by two dozen savings and loans, began offering its services through a dozen thrifts in 1982.

Forgetting for a moment the public policy implications, there seems to be some question about the wisdom of so many deposit-taking institutions chasing after a $450 million business today. One bank officer recently stated that several factors may explain the interest of deposit-taking institutions in discount brokerage.9/

9/ See Bankers News Weekly, "Discount Brokerage: More Than Fee Income Alone," February 8, 1983.

They are: (1) to attract and retain customers identified as a profitable market segment; (2) to provide additional cross-selling opportunities; and (3) to add new sources of fee income. Clearly, some deposit-taking institutions believe they will have to become financial supermarkets in order to compete effectively in the future even though most customers need fewer services than are offered by financial supermarkets and there is a great diversity in the service that any customer or set of customers requires. In other words, not all customers need an entire line of financial services and those who do may not acquire them all from any single organization.

This paper has not attempted to grapple with the thorny issues raised by bank expansion into traditional securities functions. Others are now raising these issues.10/ Furthermore, the securities industry is testing these bank-initiated moves in the courts. This litigation has become necessary in light of the unduly accommodating posture of the bank regulators and in the absence of legislative initiatives to demarcate clearly the lines of distinction between financial intermediaries. Such distinctions become increasingly blurred due to the changing ownership of securities houses, both discounters and full service firms.

The depository institutions have been effective in attracting funds to money market deposit accounts (MMDAs). Since December, about $20 billion has been attracted to savings banks.11/ Commercial banks have been even more successful, attracting 60% of total MMDS funds at all depository institutions as of February 2. This success and the problem loans to foreign countries have caused many legislative leaders to request a pause in further breaking down the lines of distinction between financial intermediaries. Despite the regulatory issues, as economists, we believe the ultimate test of bank forays into discount brokerage will be whether such activities are viable for entities whose emphasis, expertise and profitability have been in very different activities in the past.

The entry of depository institutions into discount brokerage has important short-run implications for the securities industry. It is likely that bank-sponsored discounters will take market share from discounters already in the industry due to their possession of a captive customer base already in place, convenient facilities, a large capital base, and awesome computer facilities.12/

10/ See "Bill Isaacs Stirs Up a Storm," Forbes, February 24, 1983, p. 34.

11/ See Research Analysis of Monthly Savings Bank Trends, Vol. X, No. 2, February 24, 1983.

12/ See Frederick Research Corp., The Discount Brokerage Industry, unpublished manuscript.

The extent of economies of scale in executing a large number of transactions at relatively low cost will determine the ultimate number of discounters. This is one of the few areas in the securities business where substantial economies may exist. Thus, discount brokerage may become a market served by a relatively small number of firms. Legitimate questions about the large number of deposit-taking institutions entering the discount brokerage field are raised. Is this a foray to get the "camel's nose under the tent" or are other motives involved such as precluding customers from going to competitors or preparing for the elimination of restrictions on interstate retail banking.

For full service firms, their customers will become even more aware of the availability of discounted commissions and may seek such discounts. Thus, profit margins on the retail side may come under some pressure. However, our data presented earlier indicate that many securities firms may already have anticipated such trends and focused their energies away from business lines and customer activities lending themselves to strict transactional relationships. This explains the emphasis on money management, the development of new products and the actual bottom line -- the impressive profitability of the securities industry through 1979-1982, some very turbulent years for the economy. There is no shortage of challenges facing this industry in the future but neither has there been in the past.

A return to price and interest rate stability will not bring about a return to the old structure in the market for financial services. Inflation and high interest rates have broken down many of the boundaries permanently. The securities industry has recognized this fact faster than many other intermediaries and seems prepared for the new challenges that lie ahead.

Jeffrey M. Schaefer
Senior Vice President and
Director of Research

Timothy Y. Smith
Assistant Director
of Research

SECURITIES INDUSTRY STATISTICS

VOLUME

	December 1982	YEAR-TO-DATE 1982	December 1982	YEAR-TO-DATE 1981	% CHG. Y-T-D
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	76.5	64.9	43.6	46.8	38.7
AMEX (MILS.)*	7.5	5.3	4.9	5.3	--
NASDAQ (MILS.)*	48.6	33.3	32.4	30.9	7.8
REGIONAL EXCHANGE (MILS.)*	10.9	9.1	6.3	6.2	46.8
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	55,497	488,398	28,093	389,219	25.5
AMEX (MILS.)	2,109	16,485	1,446	23,536	(30.0)
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	6,284	61,850	4,464	61,555	0.5
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	15,993	149,413	12,373	134,137	11.4
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	40.4	41.0	31.9	31.8	--
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	7,158	75,722	6,178	57,583	31.5
AMEX OPTIONS	3,734	38,767	3,429	34,859	11.2
COMMODITY	9,310	112,401	8,791	94,105	19.4

* *MONTHLY AVERAGE*

YIELDS

(MONTHLY AVERAGES)

	DECEMBER 1982	DECEMBER 1981	BASIS POINT CHANGE
BOND BUYER INDEX (20 BOND)	9.96	12.91	295
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	11.83	14.23	240
Baa CORPORATE	14.14	16.55	241
RATIO Aaa CORPS. TO Baa CORPS.	0.84	0.86	----
MUNICIPAL BOND YIELDS (MOODY'S)	9.34	11.70	236

PRICES

(END OF MONTH)

	DECEMBER 1982	DECEMBER 1981	% CHANGE Dec. '82 - Dec. '81
DOW JONES INDUSTRIALS	1046.54	875.00	19.6%
STANDARD & POOR'S 500	140.64	122.55	14.8
NYSE COMPOSITE	81.03	71.11	14.0
AMEX MARKET VALUE INDEX	338.78	320.63	5.7
VALUE LINE COMPOSITE	158.94	137.81	15.3
NASDAQ COMPOSITE	232.41	195.84	18.7

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	DECEMBER 1982	Year-to-Date 1982	DECEMBER 1981	Year-to-Date 1981	% Change, Y-T-D '82 to Y-T-D '81
NET SALES*	768.1	5164.2	118.0	1718.1	200.6%
NET PURCHASE OF COMMON STOCK*	65.5	1278.6	(4.5)	(1921.1)	-----
NET PURCHASE OF OTHER SECURITIES*	541.2	2838.5	314.1	2082.4	36.3
MUTUAL FUND CASH POSITION	8.6	----	12.1	----	-----

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS

MARGIN DEBT

	DECEMBER 1982	DECEMBER 1981	% CHANGE Dec.'82 - Dec.'81
MARGIN DEBT OUTSTANDING ($MILS)	12,980	14,150	(8.3)%
NET CHANGE IN MARGIN DEBT ($MILS)	(1,170)	(350)	----
% OF ACCOUNTS WITH EQUITY UNDER 40%	9	12	----

* ALL TIME HIGH

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	THIRD QUARTER 1982	Yr.-to-Date 1982	THIRD QUARTER 1981	Yr.-to-Date 1981	% Change 3rd Q. 1982 3rd Q. 1981	% Change Yr.-to-Date 1982-1981
REVENUE						
SECURITIES COMMISSION INCOME	1,476	3,746	1,222	4,073	20.8%	(8.0%)
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	1,789	4,159	823	3,253	117.4	27.9
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	595	1,391	323	1,167	84.2	19.2
TOTAL REVENUE	5,897	15,391	4,523	14,345	30.4	7.3
TOTAL EXPENSES	4,926	13,960	4,300	12,820	14.6	8.9
NET INCOME BEFORE TAXES	971	1,431	223	1,527	335.4	(6.3)
PERCENT OF FIRMS SHOWING LOSS	16.0%	-----	45.4%	--------	-----	-----

BEST AVAILABLE COPY

Securities Industry Trends

ANNUAL SUBSCRIPTION
$30.00 member • $48.00 non-member

AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

A8825-1 5/9/83

Vol. IX No. 2 April 26, 1983

EROSION OF GLASS-STEAGALL BARRIERS

HIGHLIGHTS

1. Banks are special institutions separate and apart from commercial ventures. It has been our national policy to shield banks from the risks of commerce and Glass-Steagall is part of that policy.

2. Since its passage in 1933, banks have attempted to erode the Glass-Steagall Act, the first major assault coming in 1935 in Congress.

3. Since then, banks have unsuccessfully attempted to underwrite mutual funds and underwriter revenue bonds, and were turned back by the courts.

4. Banks were successful in convincing the courts that they could act as an adviser to a closed-end fund.

5. Currently, bank regulators have permitted banks to distribute commercial paper of others and to operate discount brokerage services, both in the bank and through its holding company.

6. SIA has challenged the bank regulators in court maintaining that if Glass-Steagall is to be changed, Congress should do it and not some regulatory agency. All these cases are still pending.

****

SPEECH GIVEN AT 1983 EXAMINERS CONFERENCE -
FEDERAL RESERVE BANK OF NEW YORK - MARCH 8, 1983

EROSION OF GLASS-STEAGALL BARRIERS

William J. Fitzpatrick
Senior Vice President and General Counsel
Securities Industry Association

It is a pleasure to address the staff of the Federal Reserve Bank of New York on the topic of banks and securities brokers. It is rare for me when addressing this topic to appear before an audience such as this which is entirely friendly and one which I know will whole-heartedly agree with all of my conclusions. Usually I appear on programs with representatives of commercial banks or the American Bankers Association or the Comptroller of the Currency, whose views on this subject seem to vary with mine and the positions of SIA. However, if there are two organizations in the world dedicated to the preservation of the banking system in the United States, it is the Federal Reserve Bank and the SIA. Both our organizations stand for the proposition that banking is banking and commerce is commerce and never the twain shall meet.

I recently attended a seminar at which the principal speaker said that banks, insurance companies and securities firms are functionally equivalent in that they represent pools of funds which are invested to spread the risk. This seemed to me to be an oversimplification since I think it is highly important to understand the nature of the funds being pooled and from whence they derive. It has always seemed to me that banks are special institutions, deriving their funds from deposits, whereas the others are commercial institutions and derive their funds mainly from investments. The expectations and motives of depositors are light years apart from the expectations and motives of an investor. It always made sense to me that depositors fully expect the complete return of their money and that few, if any, risks will be taken with their money. Investors, on the other hand, understand that there is always an element of risk in an investment and there is always the possibility that not all of their investment or indeed any of their investment might be returned to them. Investors assume an element of risk and know that their money will be put at risk. This fundamental difference has historically been acknowledged by our political institutions and most certainly was a key underlying factor in the development of the Glass-Steagall Act.

I will not go into a discussion of explanation of the Glass-Steagall Act, since I presume that such facts are well known to this audience. However, I think it is worthwhile before we discuss the erosion of the Glass-Steagall Act to refresh our remembrances of some of the reasons why this Act

was passed. Congressional hearings in the 71st Congress in 1931 1/ had revealed a number of abuses which had arisen because of permission having been given to commercial banks to engage in investment banking and the securities business.

Some of these abuses were:

1. Borrowing money from the parent;

2. Repo transactions with the parent bank;

3. Close public identification between the affiliate and the parent bank;

4. Selling undesirable securities to the parent bank;

5. Causing the parent bank to lend money more freely than it otherwise would to finance customer purchases of issues sponsored by the affiliates in order to facilitate the distribution of such securities;

6. Causing undue price fluctuations in the parent bank's stock as a result of the affiliate's economic health

7. Causing the parent bank to engage in unsound shifting of assets and capital to and from the affiliate.

8. Permitting the affiliate to assume higher risks than the parent bank would or could assume;

9. Using bank funds to buy excess holdings of the securities affiliate;

10. The sale of the parent bank stock being pushed by the affiliate.

Keeping these abuses in mind and their possibility, we will now review the attempts to erode the principles of the Glass-Steagall Act since its passage in 1933.

The erosion started almost at the precise moment that President Roosevelt laid down his pen to shake Senator Glass and Representative Steagall's hands at the signing of the Bill. It will be noted all the way through this history that it is the banks who have constantly been attempting to erode the Act. The first public assault on Glass-Steagall came in 1935 when the banks approached the Congress to repeal the Glass-Steagall Act. The argument then was there were not enough investment bankers around to provide the necessary capital to finance industry. The amendment to permit banks back into the investment banking business was defeated in Congress to the relief of the Roosevelt administration. Senator LaFollette, in commenting on this amendment, stated "As I see it, it is the nose of the camel under the tent. Write into the law this provision

recommended by the committee and at the next session of Congress there will be proposals further to relax it. If we take this step, next year we shall have half the camel under the tent, and the next year after that we shall have the camel in the tent, and the next year after that we shall be right back where we were in 1929. "2/

After the defeat in Congress, although there was still dissatisfaction in the banking industry, most of its energies were devoted to competition within the banking community between national and state banks. The next public overt assault on Glass-Steagall was an attempt by banks to underwrite revenue bonds which are not general obligation bonds of any state or political subdivision thereof, and therefore not permissible underwriting activities for banks under the Glass-Steagall Act. The Comptroller of the Currency permitted banks to partake in the underwriting of revenue bonds issued by the Port Authority of New York. In this case, the Federal Reserve and the investment community locked arms and prevailed in court when the court agreed with the Federal Reserve Board's amicus brief that there was no such exemption in the Glass-Steagall Act permitting banks to underwrite revenue bonds. 3/ It should be noted that since this decision, it has been a perennial occasion in Washington, similar to the flowering of the cherry blossoms, for the American Bankers Association to introduce somewhere in the legislative process a proposal that would permit banks to underwrite revenue bonds. It is interesting to note that the logic of the bankers is that revenue bonds are similar to general obligations bonds, and since the Glass-Steagall Act permits banks to underwrite general obligation bonds, therefore, they should be permitted to underwrite revenue bonds. The exception given to banks to underwrite general obligation bonds was put in the Act to make certain that there would be a sufficient market for government securities and for those issued by municipalities and states. It could well be argued that in 1983 there is most certainly a sufficient investment banking industry with sufficient capital to underwrite general obligation bonds, thereby obviating the need for the exception which was granted in 1933. This makes as much, if not more, logical sense as the argument put forward by the bankers.

The next attempt at erosion was to get into the mutual fund business. Citibank, then known as First National City Bank of New York, in 1965 submitted a plan to the Comptroller to permit it to form a common trust fund and to sell public participation in this fund. This gave rise to the Investment Company Institute v. Camp 4/ case which ruled that such funds were a violation of the Glass-Steagall Act. It should be noted that the Federal Reserve Board had consistently ruled that it was improper for a bank to use a common trust fund to seek investments in it. 5/ It was only after the jurisdiction was transferred from the Federal Reserve to the Comptroller was such a fund permitted. 6/

The Supreme Court's decision changed all this by reciting all of the hazards that the Glass-Steagall Act was designed to prevent and by stating that the activity of Citibank here was nothing more than underwriting and distributing a security, which was prohibited. 7/

Next, the banks assaulted Glass-Steagall through the installation of automatic investment services ("A.I.S."). This plan permitted customers who had checking accounts to designate sums of money up to $500 to be deducted automatically from their account each month and be invested in one of 25 selected securities. The Comptroller permitted the Security Pacific National Bank to install such a plan in 1974 and the NYSE brought the matter to court. 8/ Actually, this case got horribly entangled in procedural matters and the D.C. Circuit Court eventually decided that the NYSE's right to be in court was questionable because they neither had the standing to bring this particular suit, nor was the action of the Comptroller of the Currency ripe for judicial review. 9/ This case was dropped at that point because of the complete lack of success of this plan as a commercial venture.

The next assault was on the investment advisers' end of the securities business and this time it was a bank asking to be an investment adviser to a closed end investment company, which is distinguishable from a mutual fund or an open end investment company as was involved in the ICI v. Camp case. This time the question came up under the Bank Holding Company Act and it was the Federal Reserve that ruled in favor of the plan. The Investment Company Institute brought a suit and it went all the way to the Supreme Court but this time the Court ruled against ICI. 10/ The Court distinguished between the two types of investment companies 11/ and stated that giving investment advice does not involve the issuing, underwriting or selling of securities which are the forbidden activities under the Glass-Steagall Act. 12/

The next assault came from Bankers Trust Company, which is a state chartered member bank of the Federal Reserve System. They wished to offer and sell commercial paper not issued by themselves but by third party corporations. The Federal Reserve did not rule on any application. They merely stated that commercial paper was not a security for purposes of the Glass-Steagall Act. 13/ Both A.G. Becker and SIA thought this an improper interpretation and brought action in the D.C. Court. The D.C. District Court agreed with Becker and SIA and ruled that commercial paper was a security for purposes of the Glass-Steagall Act. 14/ The Fed appealed this to the D.C. Circuit Court, which overruled the lower court and said that deference had to be given to the Fed in its interpretation of terms in the Glass-Steagall Act. 15/ This case is now on appeal to the United States Supreme Court, since SIA still is of the opinion that it is

the duty of courts to interpret acts of the United States Congress and not agencies. We also believe that the Glass-Steagall Act is a prophylactic one and not a regulatory act which permits a regulator to make day to day determinations of permissible and non-permissible conduct. The Supreme Court has sustained this position in the Board of Governors v. Agnew 16/ and also in the ICI v. Camp case.

The next erosion of the Glass-Steagall Act was an attempt by BankAmerica to purchase through its holding company a registered broker-dealer, Charles Schwab & Co. Schwab is what is commonly called a discount brokerage firm and the rationale of BankAmerica was that since Schwab did no underwriting, its security brokerage activities were closely related to banking and therefore could be a subsidiary of the bank under the terms of the Holding Act. The Federal Reserve approved this application of BankAmerica on January 7, 1983. 17/ SIA immediately went into court and asked the Second Circuit to stay and suspend the Order of the Board. This case is presently in court and both parties are preparing the necessary briefs for the Court's consideration.

The pace of erosion has most certainly quickened in the last few years. Concurrently with the Fed permitting a bank holding company to purchase a broker-dealer, the Comptroller of the Currency permitted similar activities within the bank itself. The Comptroller approved the petition of the Security Pacific bank to set up a broker-dealer within the bank 18/ and also permitted Union Planters, Chase, and also Security to purchase broker-dealers. 19/ All of these activities are challenged by SIA for the same reasons that we challenge the BankAmerica proposal and that is that any change in the Glass-Steagall Act should come about by a carefully considered act of Congress and not by erosion by some governmental agency. If the time has come to amend the Glass-Steagall Act, let's go do it out in the sunshine with very clear deliberation on the underlying national policy concerns that originally occasioned the passage of this Act and let's not do it on a piecemeal basis, case by case, with very often confusing and sometimes conflicting results.

Not to be outdone by the bank regulators, the Federal Home Loan Bank Board permitted three savings and loan associations to concoct a rather bizarre Rube Goldberg contraption in which they set up a series of tiers of service corporations until finally, way down at the bottom, you get to a registered broker-dealer. 20/ This contraption is contrived primarily to avoid the prohibitions of the Federal Home Loan Act and is really not a topic for our discussion here this morning. However, there are some Glass-Steagall implications to this. Savings and loans were not depository institutions upon the passage of either the Glass-Steagall Act or the Federal Home Loan Act. They have since become depository institutions. It is fairly clear

that the concerns of Congress in separating the commercial and investment banking activities was an attempt to isolate deposit taking institutions and to preserve them from their own folly. Now that savings and loan associations have joined the ranks of depository institutions, should not the prohibitions of the Glass-Steagall Act apply to them as well as all other depository institutions? That is a question inherent in the activities permitted by the Federal Home Loan Bank Board. SIA has commenced an action stating that a federal agency does not have the authority to amend an act of Congress. If changes are to come about, let Congress do it.

Erosion, like fungus, once it starts, is very difficult to stop. Joining the erosion explosion is the Federal Deposit Insurance Corporation. This agency permitted a state non-member bank to acquire a full-service broker-dealer when Washington Mutual Savings Bank purchased Murphey Favre Inc. This too resulted in litigation, this time led by the Investment Company Institute with SIA supporting the ICI. 21/ The permission so far has been limited to agency transactions and also to the management of a mutual fund. The principle in this case is the same as those enumerated above.

Earlier, I stated that the erosion had all come from the banking industry. Is this really so? What, you might ask, about money market funds and asset management accounts or the ownership of brokerage firms by insurance companies, and other financial conglomerates such as Sears and American Express? Did any or all of this erode the Glass-Steagall Act?

First of all, the securities industry has to be analyzed and dissected. This is an amorphous term used to lump a whole series of services which are provided by diverse and different type of organizations. The money market fund is a mutual fund. Like any open end mutual fund, it gathers together a pool of money and invests it in a portfolio. All who invest in that pooled fund share in the rewards which are reaped from that portfolio. A money market fund is simply one whose portfolio consists of various money market instruments. These have been around for some time. However, when interest rates began to soar several years ago and reached abnormally high rates and stayed there for some time, the attractiveness of this type of investment became apparent. The result of this attractiveness was an outflow of deposit funds from banks which were paying the traditional 5 1/4% interest on their funds or somewhat higher for CDs and this money flowed to the money market funds who were paying 16 and 17% based on the returns they were receiving from the money market instruments which were in the fund's portfolio. The banks who, as we have seen, have been attempting to erode the Glass-Steagall Act since day one, seized upon this event and

stormed Congress and anyone else who would listen claiming that their turf was being invaded and that they were defenseless against such incursions. Deposits became unattractive because of over cautious regulation which impeded the bank's ability to devise competititve products. There was an attempt to address this with the Depository Institution Deregulation Act of 1980 which provided a mechanism for banks to pay competitive interest rates. However, intramural squabbling among the banking community rendered this ineffective.

SIA continually called for an alleviation of regulation on the banks to permit them to become more competitive and endorsed the concept of the Depository Institution Deregulation Act and the work of the Committee created under this Act. The creation of the All Saver Certificate was also an attempt on the part of Congress to assist banks to stem their outflow. The Garn-St Germain Depository Institution Act of 1982 was another piece of legislation aimed at helping the banking community create a money market account to be competitive with the money market fund. All this now has been accomplished and there has been a noticeable return of deposit money to the banks since they have been relieved of regulatory restraints on the payment of interest (some of which was self induced) so that the tremendous hue and cry raised by the banks concerning security adventures into their territory should now abate. The major difference between a deposit and an investment, however, which I mentioned earlier in my talk is boldly underscored by this most recent event. The banks' money market account is a demand deposit fully insured by the FDIC. The money market mutual fund is an investment in which the investor runs the risks of the market without any safety net, such as federal insurance. The events of history which created artificially high rates of interest, which precipitated the transfer of funds from banks to money market mutual funds, was an accident rather than an overt attempt to erode the Glass-Steagall Act. This is a far cry from the litany of erosions listed above in which banks have overtly and unabashedly attempted to get into the securities business one way or the other, usually on the backs of some friendly regulators as a means of avoiding or evading the terms of the Glass-Steagall Act. Glass-Steagall was not even an issue in the money market fund phenomena.

This brings us to the asset management accounts, such as the Merrill Lynch CMA type of account. This involves a phenomenon called "networking." In "networking," a bank and a brokerage firm agree to a joint venture in which a packaged financial service is offered by one or both. In this package, the securities firm does what a securities firm always does and a bank does what it always does. In the CMA account, Merrill Lynch provides a margin account, the backbone of which is an investment in some money market fund and the bank provides checking and credit card

facilities. Checks or credit charges arriving at the bank are immediately forwarded to the brokerage firm which transfer sufficient cash from its account or liquidates sufficient securities in that account and then transfers the cash to the bank to satisfy the outstanding obligation. Both banks and brokerage firms have packaged such arrangements and they appear to have worked very well. The Security Pacific National Bank had a "networking" arrangement with Fidelity Discount Service and in fact Fidelity has made arrangements with a number of banks for "networking." This is not a problem under the Glass-Steagall Act since each entity does activities permitted under the Glass-Steagall Act. In fact, before Merrill Lynch launched its CMA account, it obtained permission and clearance from the Fed to make certain that there were no problems with this type of arrangement.

Sears, American Express, Prudential, as well as other insurance companies now own brokerage firms. Under the Glass-Steagall Act, this is all permissible activity. There is nothing in the Glass-Steagall Act which prevents an insurance company which is commercial venture from investing in another commercial venture, such as a brokerage firm. The same can be said of American Express and Sears. All that these corporations did was to purchase a subsidiary which is a fully registered broker-dealer subject to the rules and regulations of the Securities and Exchange Commission and the broker-dealer entity exists as it always has existed by doing the things that it has always done. There are no Glass-Steagall questions involved in such arrangements nor is there any erosion of Glass-Steagall in this.

Before ending the litany of possible alleged erosions by the securities side of the equation, I must mention the purchase by securities firms of certain trust companies. These have been referred to as "non-banks." This is because they usually do not perform the two basic functions which make a bank a bank, that is, to accept deposits and to make commercial loans. It seems to me the problem, if there is one with this type of an arrangement, is the lack of a clearcut definition of the nature of a bank. This, it seems to me again, is a question for Congress and perhaps it all can be sorted out when and if the Congress addresses the whole question of financial intermediaries.

It appears to me that commentators have been extremely glib in referring to the blurring of the lines of distinction between banks and other financial institutions. I think it takes a certain amount of reflex thinking to conclude that money market funds and CMA accounts are banking activities. Careful review shows that they are not. Any erosions or blurring of the Glass-Steagall lines has been occasioned by overt activities of banks to get into the securities business. The underlying policy question is, is that a good thing for banks to do and is it good national

policy to allow a bank to engage in commercial, risk prone endeavors? This is a question that should be resolved by Congress after careful deliberation and debate. The frantic rush by banks and bank regulators to permit banks to do pretty much what they want to do in the area of securities activities does not appear to be the correct approach to these questions at all.

A frenetic and frantic endeavor by banks to involve themselves in as many facets of the securities business as they can in as short as possible time might be highly detrimental to the banking system of this country. This is not an area in which they have any particular expertise. It is an extremely technical area and one which is fraught with risk. One wonders why bank administrators who are charged with the preservation and the soundness of the banking system would be so willing to permit banks to engage in such activities without some clear indication from Congress that this is a good policy and one which the nation should pursue.

This was clearly not the policy that Congress established in 1933 and since they have not spoken since, it is difficult to understand where the bank regulators are getting their message. It seems to me they are getting their message solely from banks who have not always been the best judge of what is good for them. Witness 1929 and witness the words of Senator LaFollette. There is more than the nose of the camel in the tent right now. Before we all go over the hump, bank regulators should really sit down quietly in a dark room and consider what is the inevitable results of the actions they are taking today.

It seems to me that we are paying the Congress of the United States good money to do its job. We should let them do it in this case.

1. Hearings Pursuant to S. Res. No. 71 Before a Subcommittee on Banking and Currency, 71st Cong. 3d Sess., Part 1 (1931).

2. 79 Cong. Rec. 1193 (1932).

3. Port of New York Authority v. Baker, Watts & Co., 392 F.2d 497 (D.C. Cir. 1968). The Court construed the Glass-Steagall Act as a remedial measure, declining to expand the definition of "general obligation bonds" where Congress had not done so. Id. at 504.

4. 401 U.S. 617 (1971).

5. See, e.g., 42 Fed. Res. Bull. 228 (1956); 41 Fed. Res. Bull. 142 (1955); 26 Fed. Res. Bull. 393 (1940).

6. See 12 C.F.R. §9.18(a)(3)(1963). These regulations expressly authorized the collective investment of monies placed in "managing agency accounts," i.e., accounts established for investment management.

7. 401 U.S. at 639.

8. New York Stock Exchange, Inc. v. Bloom, 562 F.2d 736 (D.C. Cir. 1977). This decision vacated a previous Federal District Court for the D.C. District decision, New York Stock Exchange, Inc. v. Smith, 404 F. Supp. 1091 (D.D.C. 1975), which had dealt with the same issue.

9. 562 F.2d at 741-42.

10. Board of Governors of the Federal Reserve System v. Investment Company Institute, 450 U.S. 46 (1981).

11. Id. at 66-78.

12. Id. at 71.

13. Board of Governors of the Federal Reserve System, Commerical Paper Activities of Commercial Banks: A Legal Analysis (1979).

14. A.G. Becker, Inc. v. Board of Governors of the Federal Reserve System, 519 F. Supp. 602 (D.D.C. 1981).

15. A.G. Becker, Inc. v. Board of Governors of the Federal Reserve System, 693 F.2d 136 (D.C. Cir. 1982).

16. 329 U.S. 441 (1946). In this case, the Court held that a firm with a substantial underwriting business is "primarily" engaged in underwriting for Glass-Steagall purposes. Id. at 446.

17. Bank America Corporation, San Francisco, Calif.; Order Approving Acquisition of Retail Discount Brokerage Firm, 69 Fed. Res. Bull. 105 (January 7, 1983).

18. See Comptroller's Quarterly Journal #4, at 40 (August 26, 1982).

19. Unpublished opinion, August 26, 1982.

20. See 47 Fed. Reg. 9855 (March 8, 1982).

21. In Re. Washington Mutual Savings Bank, et al (F.D.I.C., filed July 27, 1982).

APPENDIX

CURRENT STATUS OF SIA BANK LITIGATION (AS OF 4/25/83)

1. Commercial Paper case - A. G. Becker Inc. and SIA v. Board of Governors of the Federal Reserve System (see footnotes 14 and 15). A petition for certiorari will be filed with the U. S. Supreme Court during the week of April 25, 1983.

2. BankAmerica/Schwab case - SIA v. Board of Governors of the Federal Reserve System (File 83-4019 United States Court of Appeals for the Second Circuit). Briefs have been filed by both sides. No date for oral argument has been set but it could take place in May 1983.

3. Security Pacific and Union Planters case - SIA v. C. T. Conover as Comptroller of the Currency. (File 82-2865 United States District Court for the District of Columbia). Both sides have made motions for summary judgments and briefs have been filed. Oral argument will be on May 6, 1983.

4. The Savings and Loan, Invest case - SIA v. the Federal Home Loan Bank Board (File 82-1920 United States District Court for the District of Columbia). Oral argument took place on February 2, 1983. Awaiting a decision.

SECURITIES INDUSTRY STATISTICS

VOLUME

	JANUARY 1983	YEAR-TO-DATE 1983	JANUARY 1982	YEAR-TO-DATE 1982	% CHG. Y-T-D 1983 - 1982
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	88.5	88.5	48.4	48.4	82.9%
AMEX (MILS.)*	9.2	9.2	4.5	4.5	104.4
NASDAQ (MILS.)*	57.9	57.9	27.8	27.8	108.3
REGIONAL EXCHANGE (MILS.)*	12.1	12.1	6.6	6.6	83.3
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	62,530	62,530	28,868	28,868	116.6
AMEX (MILS.)	2,488	2,488	1,294	1,294	92.3
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	7,724	7,724	5,136	5,136	50.4
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	16,196	16,196	8,801	8,801	84.0
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	42.3	42.3	35.4	35.4	--
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	6,920	6,920	6,344	6,344	9.1
AMEX OPTIONS	3,467	3,467	3,075	3,075	12.7
COMMODITY	11,019	11,019	7,635	7,635	44.3

** MONTHLY AVERAGE*

YIELDS

(MONTHLY AVERAGES)

	MARCH 1983	MARCH 1982	BASIS POINT CHANGE
BOND BUYER INDEX (20 BOND)	9.20	12.82	(362)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	11.73	14.58	(285)
Baa CORPORATE	13.61	16.82	(321)
RATIO Aaa CORPS. TO Baa CORPS.	0.86	0.87	(1)
MUNICIPAL BOND YIELDS (MOODY'S)	8.42	11.95	(353)

PRICES

(END OF MONTH)

	MARCH 1983	MARCH 1982	% CHANGE Mar.'83 - Mar.'82
DOW JONES INDUSTRIALS	1130.03	822.77	37.3
STANDARD & POOR'S 500	152.96	111.96	36.6
NYSE COMPOSITE	88.03	64.52	36.4
AMEX MARKET VALUE INDEX	389.08	260.12	49.6
VALUE LINE COMPOSITE	179.25	125.31	43.0
NASDAQ COMPOSITE	270.80	175.65	54.2

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	Fourth Quarter 1982	Yr.-to-Date 1982	Fourth Quarter 1981	Yr.-to-Date 1981	% Change 4th Q. 1982 4th Q. 1981	% Change Yr.-to-Date 1982-1981
REVENUE						
SECURITIES COMMISSION INCOME	2,270	6,021	1,268	5,346	79.0%	12.6%
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	2,397	6,553	1,563	4,813	53.4	36.2
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	928	2,319	405	1,572	129.1	47.5
TOTAL REVENUE	7,821	23,212	5,449	19,802	43.5	17.2
TOTAL EXPENSES	6,226	20,186	4,831	17,666	28.9	14.3
NET INCOME BEFORE TAXES	1,595	3,026	618	2,139	158.1	41.5
PERCENT OF FIRMS SHOWING LOSS	9.3%	--	26.8%	--	--	--

SOURCE: FOCUS REPORT X-17A-20

UNDERWRITING
(DOLLARS IN MILLIONS)

	DECEMBER 1982	Grand Total 1982	DECEMBER 1981	Grand Total 1981	% Change December'82 December'81	% Change 1982 - 1981
CORPORATE FINANCING (Gross New Issues)						
Total	10,179	78,987	6,047	63,742	68.3	23.9
Common Stock	3,224	16,493	996	15,045	223.7	9.6
# Of Common Stock Issues	106	680	76	488	39.5	39.3
Preferred Stock	487	5,299	145	1,676	235.9	216.2
# Of Preferred Stock Issues	15	96	4	42	275.0	128.6
Corporate Debt	6,468	57,196	4,906	47,020	318.4	21.6
# Of Corporate Debt Issues	61	642	56	488	8.9	31.6
MUNICIPAL FINANCING* (Gross New Issues)						
Total	11,068	117,792	8,210	80,580	34.8	46.2
Notes	2,890	42,915	3,138	34,443	(7.9)	24.6
Bonds	8,178	74,877	5,072	46,137	61.2	62.3
# of Bond Issues	549	5,561	433	4,242	26.8	31.1
Negotiated Bonds	6,265	50,769	3,951	29,761	58.6	70.6
Revenue Bonds	6,407	51,810	4,136	32,146	54.9	61.2

*Preliminary Figures

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	FEBRUARY 1983	Yr.-to-Date 1983	FEBRUARY 1982	Yr.-to-Date 1982	% Change, Y-T-D '82 to Y-T-D '83
NET SALES*	1125.3	2467.1	266.8	651.6	278.6%
NET PURCHASE OF COMMON STOCK*	728.8	1442.7	117.0	(796.0)	--
NET PURCHASE OF OTHER SECURITIES*	243.5	(56.1)	301.6	247.6	--
MUTUAL FUND CASH POSITION	9.5	--	11.8	--	--

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS

MARGIN DEBT

	MARCH 1983	MARCH 1982	% Change Mar.'83-Mar.'82
MARGIN DEBT OUTSTANDING ($MILS)	14,170	11,840	19.7%
NET CHANGE IN MARGIN DEBT ($MILS)	2,870	2,180	31.7
% OF ACCOUNTS WITH EQUITY UNDER 40%	9	12	--

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
Transcript of SIA Trends Conference on "The Changing Face of Wall Street"	At the fourth annual Trends Conference, panelists from securities firms and other financial intermediaries discussed the "Changing Face of Wall Street" from their particular vantage point. The discussion focused on: linking financial products and services, the benefits of being "small," internationalization of the marketplace and strategies for coping with volatile interest rates. Panelists included George Ball, John Heilshorn, John Wing, Peter Tanous, Bill Kneisel and Steve Bansak. The luncheon speaker, Senator Paul S. Sarbanes, gave an update on Washington's view of the financial services industry.	Research Department SIA 120 Broadway-35th Fl. New York, New York 10271 $25
Transcript of SIA Topical Forum on Domestic Withholding and Expanded Broker Reporting Requirements, December 14, 1982	The compliance provisions in the Tax Equity and Fiscal Responsibility Act of 1982 place a heavy burden on the securities industry. At SIA's Forum, industry legal and operational experts discussed the regulations and the problems inherent therein as they affect firms, products, and customers. In addition to an in-depth explanation of the regulations, approaches to implementation plans and solutions to problems were offered.	Research Department SIA 120 Broadway-35th Fl. New York, New York 10271 $25
"What is a bank?"	An examination of the term "bank" as it is defined in the Bank Holding Company Act of 1956 and its later amendments and a review of the subsequent interpretations by the Board of Governors of the Federal Reserve. Analysis based on board and staff letters and orders to determine what constitutes "commercial loans," "engaged in the business of making commercial loans," "demand deposits" and "bank." Concise table summary of Board actions bearing on definition of "bank" since 1971. Since the Board	Economic Perspectives Federal Reserve Bank of Chicago 1983

ITEM	DESCRIPTION	SOURCE
	has indicated to Congress that it is prepared to recommend changes in the definition of "bank," the article offers food for thought on what its recommendations might be.	
"Are Banks Special?"	Essay affirmatively answers the question after examining three essential functions banks perform: handle transaction accounts, provide a backup source of liquidity to all other institutions, and serve as the transmission belt for monetary policy. The availability of a public safety net -- deposit insurance and access to the lender of last resort -- to banks only underscores their uniqueness. A simple definition of banks is drawn, "any institution that is eligible to issue transaction accounts," and four implications of this definition are discussed.	Annual Report 1982 Federal Reserve Bank of Minneapolis
"How Dreyfus Plans to Beat the Banks"	When the regulatory restrictions that kept banks from offering competitive interest rates on short-term savings were lifted, the spectacular growth of money market funds came to a halt. In the first two months of 1983, the cash in Dreyfus Liquid Assets fund shrank by more than 14.5%. However, Howard Stein, chairman of the Dreyfus Corp., is planning to rebuild market position by acquiring a string of specialty shops, each offering a few carefully designed financial products nationwide.	Fortune 3/21/83
"Impact of IRAs on Savings"	This article considers to what extent the 1981 IRA legislation is likely to increase the amount of saving in the economy. Historical evidence shows a low 6% participation of eligible individuals in IRAs, with annual contributions averaging 4.4% of their potential level. IRA contributions in 1982 are estimated at $25 billion, substantially more than the estimated $4 billion placed in IRAs in 1981 under the old law. However, the increased IRA contributions may reflect only a shift of assets, not new savings, and an estimated tax loss in 1982 of $7-$8 billion.	Quarterly Review Federal Reserve Bank of New York Winter 1982-1983

ITEM	DESCRIPTION	SOURCE
"CFOs Like Those 415s"	Short review of select corporate finance executives' opinions on Rule 415. Despite the opposition of investment bankers, Rule 415 has generated enthusiastic backing from some users. Corporate officers point to cost savings and also dismiss negative arguments about market overhang. However, other corporate issuers are cautious users lest they jeopardize long-standing Wall Street relationships.	Investment Dealers' Digest 3/29/83
Capital Markets Outside The U.S.	A special subcommittee of SIA has prepared this booklet in order to focus the attention of interested parties on the size of overseas capital markets, the degree of U.S. corporate involvement in them and the extent to which continued access to those markets is vital. Two independent situations, the renegotiation of the U.S./Netherlands Antilles Tax Treaty and the uncertainty as to whether U.S. withholding taxes will be imposed on past and future Eurobond issues by U.S. corporations, might have adverse effects on future access to overseas capital markets.	Research Department SIA 120 Broadway-35th Fl. New York, New York 10271 $5.00
The Financial Health of U.S. Corporations	Concise 18-page booklet tracing the deterioration of the financial condition of American corporations by highlighting such measures of corporate health as corporate profits, the quick ratio, and the interest coverage ratio. The report points out that, while the recent recession strained corporate liquidity, corporate finances have been deteriorating for more than a decade. A number of policy options designed to ease the corporate debt burden are reviewed.	Office of Economic Research New York Stock Exchange

ITEM	DESCRIPTION	SOURCE
Marketplace: A Brief History of the New York Stock Exchange	Illustrated 52-page book tracing the evolution of the NYSE from its origins in the late 18th century to today's electronic computerized trading floor. The Exchange's role in financial and industrial growth of the nation and the contributions of various members who helped shape America's securities markets are highlighted. This is the first time the Exchange has issued such a history for a general audience.	Publications Department New York Stock Exchange 11 Wall Street New York, New York 10005 $5.95

NOTE

This Microfiche meets the quality requirements of the American National Standard for Microfiche of Documents (ANSI PH5.9-1975). However, because of imperfections in the document from which it was made, it contains images that are illegible or difficult to read. The source document for this microfiche is the best copy that could be obtained prior to filming.

Congressional Information Service, Inc.
Washington, D.C.
CIS

Securities Industry Trends

ANNUAL SUBSCRIPTION
$30.00 member • $48.00 non-member

AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

A8825-1 6/24/83

Volume IX No. 3 June 1, 1983

YEAR IN REVIEW 1982: PART I

HIGHLIGHTS

1. Industry profitability has been at a high level since 1979 because of significant revenue increases which have hidden escalating expenses. The compound annual growth rate for revenues was 27.4% from 1979-1982; for expenses, it was 25.8%.

2. Last year was a prime example of the volatility which is characteristic of the securities industry. Industry profitability varied from a low of 5.4% after-tax ROE during the first quarter to a high of 42.8% for the fourth quarter.

3. The ten largest firms outperformed the smaller firms for the first six months of 1982 because of their greater diversification. However, the smaller firms' profitability exceeded the ten largest in the fourth quarter when activities related to distributing, trading, and executing securities -- the traditional industry staples -- soared.

4. The securities industry outperformed the Fortune 500 companies by a wide margin in 1982. For example, sales for the largest companies fell 5.7%, while the securities industry's revenues jumped 17%, reaching a record $23.2 billion. In addition, the profitability of the Fortune 500 companies plunged 27%, and after-tax ROE was only 10.9%. In comparison, the securities industry's profitability climbed 43%, with after-tax ROE rising to 21.8%. These comparisons help explain the interest of "outsiders" in acquiring securities firms and why regional firms are desired by larger securities firms.

5. Capital requirements continue to rise because of principal activities. In 1982, total capital jumped from $8.2 to $10,.8 billion at year-end, while equity capital climbed nearly $2.3 billion to $8.9 billion.

Introduction

The "Year in Review 1982" Trends will be divided in two parts. In Part I, we will discuss overall profitability in the industry, profitability by firm category, aggregate revenues, and aggregate expenses. We will also discuss the volatility of profits, revenues, and expenses on an aggregate basis and for some firm categories as well. In the next issue of Trends, we will examine in greater detail different firm categories and analyze trends in changing market share for different revenue sources. Changing market shares will be discussed not only by firm category but by size of firm as well.

Last year was a prime example of the volatility which is characteristic of the securities industry. For the industry, gross revenues bounced from a low of $4.5 billion during the first quarter to a high of $7.8 billion during the fourth quarter. Most major industry revenue sources showed a similar pattern of volatility. For example, commission revenues increased from about $1.2 billion in the first quarter to $2.3 billion during the last three months, while trading profits jumped from $1.1 billion to $2.1 billion. Underwriting revenues spurted from $360 million to about $930 million. Only margin interest, of the major revenue sources, showed a decline as the year progressed. Margin interest started out at somewhat less than $600 million and dropped to $420 million by year's end, reflecting both a fall in margin debit balances as well as plunging interest rates.

Significantly, the relative importance of revenue sources not closely related to the securities business fell in importance throughout the year. For example, revenues in the "Other" category, both related and unrelated to the securities business, accounted for about one-fourth of revenues during the first half of 1982. By the fourth quarter, these two revenue categories declined to less than 18%. In effect, the industry's traditional functions, trading, underwriting, and distributing securities, rebounded sharply during the last half of 1982 and has continued during the first part of 1983.

Changes in the economic outlook had much to do with last year's volatility. The economic environment for the first half of 1982 contrasted sharply with that of the second half. Conditions were bleak during the first six months as the economy remained mired in the worst recession since World War II. More important, the economic outlook was discouraging because of the collision between loose fiscal and tight monetary policies. Fiscal policy was projected to yield higher deficits not only in the current fiscal year but the "outyears" as well.

Both nominal and real interest rates remained very high. In addition, expectations existed that with economic recovery, interest rates could rise again thereby inhibiting any improvement. In this economic environment, securities firms could not expect to prosper. Interest in the stock market

receded because of the weak financial condition of many corporations and the poor profit outlook. Also, high returns with little risk could be obtained in the money markets. Underwriting activities in the corporate area remained weak because of high interest rates while equity prices remained depressed.

The economic environment altered significantly during the second half of 1982. Interest rates declined and the rate outlook became much brighter. The Federal Reserve was the driving force behind the lower rates by switching its emphasis from primarily fighting inflation to fighting recession. It wanted interest rates to fall because of prolonged economic weakness, evidence of new financial difficulties, significant improvement in the inflation rate, and concern over the financial problems of many foreign countries. Under the new approach, monetary targets became more flexible while attention was also paid to other factors such as the level of interest rates and the condition of money markets. The discount rate was reduced seven times. In addition, TEFRA was enacted which was a step towards correcting the mismatch between fiscal and monetary policies. Securities firms prospered in this economic environment with a resurgence of interest in equities due to declining interest rates which generated trading profits and improved conditions for underwriting activities.

Industry Profitability

Net income after taxes reached a record $1.7 billion in 1982, nearly 44% greater than 1981. Revenues increased $3.4 billion, or 17%, while expenses jumped by $2.5 billion, or 14%. The results of the first six months of 1982 were dismal while for the last half of the year they were spectacular. For example, 43% of NYSE member firms were unprofitable during the first quarter and 38% during the second quarter. In the fourth quarter alone, the industry's dramatic performance resulted in producing almost 54% of 1982's net income. Still, 9% of member firms were unprofitable.

Last year was not without its headaches. For many firms, not only was profitability nonexistent during the first half, but losses were actually incurred. The turnaround was particularly remarkable for traders and market-makers. These firms showed substantial losses in the first quarter, which narrowed somewhat by the time summer arrived. This category benefitted from the boom of the second half when their profits spurted to over 60% on an annualized after-tax return on equity (ROE) basis. For the year, their estimated after-tax return on equity amounted to just under 25% -- an impressive achievement given their negative 18% ROE during the first three months.

Profitability, as measured by the after-tax return on equity was 21.8% in 1982 compared to 18.9% in 1981. Although profitability was excellent, it was not a record. After-tax ROE was higher in 1980 when it reached the record 25.7%. Obviously,

quarterly profitability was significantly different during the year. Annualized after-tax ROE in the first quarter was only 5.4%, and just 9.0% in the second quarter. In the third quarter, after-tax ROE climbed to 28.4%, while soaring to 42.8% in the fourth quarter.

The following firm categories exceeded the ROE for the industry: Large Investment Bankers, New York City Based Regional firms, Traders and Market Makers, Commission Introducing firms, and Discounters. The National Full Line firms and Regionals Based Outside New York both had returns on equity below the industry average. The National Full Line firms earned an estimated after-tax ROE of 16.7%. For Regional firms, it was 19.5%. Interestingly, for Regional firms based outside New York, the smaller firms outperformed the larger firms. In terms of New York City based regionals, there was a perceptible difference between the performance of large and small firms. The larger firms' ROE was more than double that of the small firms.

As noted earlier, 1982 was a year of ups and downs. Fortunately, the year ended on a resounding upbeat note and the momentum has carried through May of 1983. In terms of quarterly performance, industry after-tax ROE ranged from a low of 5.4% to a high of almost 43%. Naturally, for certain categories of firms, the peaks and valleys were even more extreme.

Table 1

Average Annualized After-Tax Return on Equity
by Firm Category

Sectors	Full Year 1982	1982 1Q	2Q	3Q	4Q
Total Securities Industry	21.8	5.4	9.0	28.4	42.8
National Full Line Firms	16.7	-0.6	4.1	22.1	39.5
Large Investment Banks	28.6	15.2	17.3	38.7	43.8
Regional Firms	19.5	4.6	6.8	21.3	43.9
New York Regional Firms	23.2	1.6	8.3	27.3	53.6
Traders and Market Makers	24.6	-18.3	-1.3	47.9	62.3
Commission-Introducing Firms	31.7	8.7	13.8	42.3	60.6
Discounters	29.6	NA*	2.7	38.1	71.6

* The ROE for discounters for the first quarter could not be computed because year-end capital figures for 1981 were not available. The methodology used in this paper for estimating the quarterly return on equity involves taking average capital for the quarter, and dividing this figure into the quarterly income figure which, in turn, was annualized.

Once again, size seemed to have little to do with performance. After-tax ROE was almost identical for the largest and smallest firms in the industry. The 10 largest firms had an estimated after-tax ROE of 21.5% for 1982 as compared to 22% for the rest of the industry. This 22% was also the ROE for firms ranked 11-25. Firms below the top 25 had a ROE just a tad over 22%. For most of 1982, the 10 largest firms outperformed smaller firms in the industry. But when the roaring market was in full swing during the latter part of the year, the smaller firms, more heavily dependent on the traditional products of the industry, benefitted even more than the largest firms. For example, those firms below the top 25 in terms of total capital had an after-tax ROE of almost 46% during the fourth quarter as compared to 38.6% for the top 10 firms. Firms ranked 11 through 25 benefitted the most, earning, after taxes, an estimated ROE over 50%.

Table 2

Average Annualized After-Tax Return on Equity
by Firm Size

	Full Year 1982	1982 1Q	2Q	3Q	4Q
Total Securities Industry	21.8	5.4	9.0	28.4	42.8
Top Ten Firms	21.5	7.6	10.5	28.9	38.6
Top Eleven to Twenty-Five Firms	22.0	-1.7	6.2	27.7	51.2
Top Twenty-Five Firms	21.6	5.6	9.5	28.6	41.7
Balance of Industry	22.1	4.9	7.8	28.0	45.8

The securities industry's performance during 1979-1982 has been impressive. We estimate that after taxes, the ROE has been 15.6%, 25.7%, 18.9%, and 21.8% over the last four years. Certainly, the rapid revenue growth has had much to do with this. From 1979-1982, revenues more than doubled from $11.2 billion to over $23 billion. During this time span, other revenues both related and unrelated to the securities business literally tripled as did revenues from mutual fund sales and, surprisingly, underwriting. However, underwriting started from a depressed base in 1979. Trading profits continued their impressive rise during these four years.

Last year, revenues jumped over 17% to a record $23.2 billion. The performance of the securities industry is in stark contrast to companies included in the Fortune 500. For the largest companies in the United States, sales actually declined

by 5.7% in 1982.* This decline in total sales was the second drop ever and the first since 1958. Furthermore, the Fortune 500 had an overall profit decline of 27% in 1982 as compared to the securities industry's 43% increase. The median return on equity in 1982 was 10.9% as compared to almost 22% for the securities industry. In 1981, the Fortune 500 did only slightly better, with a median return on equity after taxes of 13.8% compared to the securities industry's 19.2%. The strongest proof of the recovery in the securities markets is the interest once again by retail customers in mutual funds. The sales of such funds accounted for only $77 million in revenues in 1979. In 1982, this figure reached almost $300 million.

Industry Revenues

Commissions

In terms of detailed revenue data, commissions from executing listed transactions on an exchange accounted for only 19% of revenues in 1982 as compared to almost 28% in 1979. All commission revenues have declined in relative importance, but this category explains the drop in the relative importance of commission revenues the most (see Table 3).

During 1982, there were 25 days during which more than 100 million shares were traded on the NYSE. The reported annual volume hit 16.46 billion shares, almost 39% above the 1981 record. As widely noted, the record daily volume was 149.4 million shares. At the same time, NASDAQ volume hit an all-time annual high of 8.4 billion shares traded. The record daily volume hit 70.5 million shares on November 4, the same day that the NYSE daily volume hit its record high.

On the NYSE, large block activity rose to new heights in 1982, breaking every existing record along the way. An average of 1,007 block trades crossed the tape each day, roughly three per minute, nearly doubling the amount recorded the previous year. Block trading as a percent of NYSE reported volume reached an unprecedented 41%, exceeding 40% for nine months of the year -- April through December. This contrasts sharply with the relative importance of such blocks in 1981 when they averaged 31.8% of reported volume on the NYSE. In fact, last year's low month of 35.4% for blocks during January exceeded that for the record month in 1981; 34.7% in June.

---

* See Fortune, May 2, 1983, pp. 226-227.

Table 3

Securities Industry Revenue Breakdown, 1979-1982
(millions of dollars)

REVENUES *	1979 Dollars	1979 % of Total	1980 Dollars	1980 % of Total	1981 Dollars	1981 % of Total	1982 Dollars	1982 % of Total
Commissions								
Listed Equities on an Exchange	3,133.0	27.9	4,234.0	26.4	3,950.0	20.0	4,492.0	19.3
Listed Options	447.0	4.0	717.0	4.5	612.0	3.1	741.0	3.2
All Other	442.0	3.9	726.0	4.5	779.0	3.9	792.0	3.4
Total	4,022.0	35.8	5,677.0	35.4	5,341.0	27.0	6,025.0	25.9
Trading Profits								
Market Making OTC	440.0	3.9	666.0	4.2	609.0	3.1	658.0	2.8
Debt Securities	1,161.0	10.3	1,896.0	11.8	3,083.0	15.6	4,463.0	19.2
All Other	557.0	5.0	577.0	3.6	551.0	2.8	839.0	3.6
Total	2,158.0	19.2	3,139.0	19.6	4,243.0	21.4	5,960.0	25.7
Investment Profits	492.0	4.4	561.0	3.5	575.0	2.9	598.0	2.6
Underwriting								
Equity Securities	177.0	1.6	405.0	2.5	428.0	2.2	330.0	1.4
Total	771.0	6.9	1,330.0	8.3	1,573.0	7.9	2,322.0	10.0
Margin Interest	1,655.0	14.7	2,088.0	13.0	2,892.0	14.6	2,016.0	8.7
Mutual Fund Sales	77.0	0.7	107.0	0.7	123.0	0.6	290.0	1.2
Account Supervision	124.0	1.1	178.0	1.1	278.0	1.4	359.0	1.5
Research	14.0	0.1	16.0	0.1	18.0	0.1	25.0	0.1
Commodities	437.0	3.9	628.0	3.9	583.0	2.9	669.0	2.9
Other - Related	1,162.0	10.3	1,726.0	10.8	2,960.0	15.0	3,945.0	17.0
Other - Unrelated	359.0	3.2	589.0	3.7	1,229.0	6.2	1,051.0	4.5
GROSS REVENUE	11,233.0	100.0	16,020.0	100.0	19,796.0	100.0	23,224.0	100.0

* Discrepancies may exist due to rounding.

Source: SIA/DRI/NYSE Database

Table 4

Relative Importance of Large Block Transactions

	Total Transactions	Shares (Thous.)	Percent of Reported Volume
1981			
Year	145,564	3,771,442	31.8%
1982			
1 Q	42,673	1,181,588	36.8
2 Q	53,533	1,404,941	42.9
3 Q	71,815	1,877,929	43.0
4 Q	87,686	2,278,023	40.6
Year	254,707	6,742,481	41.0
1983			
1 Q	89,000	2,327,756	43.3

Source: NYSE

The depth of the market plunge from mid-1981 through August, 1982 is indicated by the fact that the average price of shares traded on exchanges was, in effect, virtually unchanged from 1977 to 1982 on the NYSE, slightly off on the AMEX, and down considerably on regional stock exchanges. From 1981 to 1982, the average price of a share traded on the NYSE dropped from $32.38 to $28. For the AMEX, the drop was $17.92 to $12.93. On all registered stock exchanges, the decline was to $30.84 from $36.69, a 16% drop. The decline in the average price of shares traded kept the increase in commission revenues down, given the surge in volume experienced in 1982.

Table 5

Average Price of Shares Traded on Registered Stock Exchanges
(Amounts in Dollars)

Year	Annual Average Price of Shares Traded on: New York Stock Exchange	American Stock Exchange	All Regional Stock Exchanges	All Registered Stock Exchanges
1977	$28.01	$13.09	$28.26	$26.66
1978	27.62	15.30	27.04	26.28
1979	28.94	17.73	27.69	27.63
1980	32.10	20.92	30.26	30.73
1981	32.38	17.92	30.34	30.84
1982	28.00	12.93	25.82	26.69

Source: SEC

Trading

In terms of trading profits, the dramatic increase has come about in debt securities -- corporates, municipals and governments. Whereas trading profits accounted for 19% of revenues in 1979, this percentage exploded to just under 26% in 1982. In actuality, the relative increase in importance of trading profits has come solely from the debt side as trading profits from equities actually fell in relative importance. For the year, trading profits are now as important to the industry as commission revenues, just under 26%. For some categories of firms, trading profits are even more important. The growth in this revenue source helps to explain the greater capital requirements imposed upon firms in a very competitive environment.

Underwriting

The remarkable recovery in the securities markets account for the increased importance of underwriting revenues. Once again, underwriting revenues have reached double digits in relative importance, amounting to 10% of gross revenues in 1982, up from less than 7% in 1979. The increased importance came strictly from the debt side as underwriting equity securities accounted for only 1.4% of gross revenues in 1982, virtually unchanged from 1979. Indeed, the relative importance of underwriting equities last year was less than in 1980 and 1981, when many corporations used the spurt in the equity market to obtain new equity financing. For the most part, the recovery in the stock market was relatively late last year and followed

plunging interest rates, which most corporations and governmental units took advantage of to move ahead with long-delayed debt financings.

During 1982, corporations broke the previous record of financings of $64 billion reached in 1981. Almost $79 billion of securities were underwritten in 1982, representing a 23% increase over the previous year.* Almost two-thirds of this $79 billion, or about $52 billion, was offered during the second half of the year. In the fourth quarter alone, $29 billion of the total amount for the year, or 37%, was brought to market. Plunging interest rates lit a fire under CFOs as they rushed to the marketplace to rebuild their corporate balance sheets.

Each class of security broke its previous annual record. Total bond offerings came to over $51 billion. However, original issue discount (OID) offerings, and especially their extreme version, zero coupon bonds, inflated these nominal figures somewhat because such issues are recorded at face value. Preferred stock offerings also set a yearly high. Almost $5.3 billion of preferred stock were brought to market, more than tripling 1981's $1.7 billion total. The 1982 figure substantially exceeded the 1980 record $3.2 billion.

In terms of common stock offerings, a record $16.5 billion was underwritten in 1982. This was about a 10% increase over the previous year's record $15 billion. Almost two-thirds of the dollar value came during the July-December second half. Even more startling was the percentage handled in the fourth quarter alone. During that quarter, almost half, or $7.5 billion, of the total year's common stock was distributed.

From all the signs this year, these impressive figures will be surpassed easily. The market rally has continued, interest rates have stabilized, and the record set last year may well become a part of history if the high levels of primary market financings continue at their present explosive rate. One important difference between 1983 and 1982 is in the surge in initial public offerings (IPOs). The 1982 figure actually trailed that for 1981 and 1980. Whereas $1.8 billion of IPOs had been raised in 1980 and $3.7 billion in 1981, this figure tumbled to only $1.4 billion in 1982. Since the market rally got underway late and started in the blue chips first, the IPO market was late in gathering momentum. This helps to explain the lack of a substantial increase in underwriting revenues in terms of equity as compared to debt offerings in 1982.

Besides the corporate sector, the pace of activity in governments was phenomenal last year. All levels issued record amounts of securities. According to the Public Securities

---

* Directory of Corporate Financing, Investment Dealers' Digest, March, 1983, pp. 12-14.

Association, the Treasury issued $145 billion of securities, bringing the total outstanding to $840 billion. Federal agency securities alone grew by $65 billion, to $390 billion. Municipal securities issued amounted to $122 billion, bringing total municipal debt outstanding to $450 billion. The distribution of municipal securities exploded as the average weekly yield on munis fell from 13.3% at the beginning of the year to 9.6% at year-end.

Of the $122 billion issued in municipal securities, long-term volume amounted to $77.3 billion. Issuers flooded the market because of declining interest rates which made postponed offerings more attractive and concern over a proposed federal regulation that all municipal securities would have to be issued in registered form in order to remain exempt from federal taxation. Individuals purchased 75% of new municipal issues. Due to low profitability in 1982, commercial banks and property and casualty companies played relatively minor roles relative to past years.

The outlook for municipal offerings this year remains very strong. Many observers believe that the nation's infrastructure is in sad shape, thus, municipalities must come to the market to rebuild their roads, highways, schools, etc. In addition, with federal cutbacks, an even greater effort will be required by states and localities to fill the void of increasing demands with less funds coming from the federal government.

Margin Interest

As noted earlier, declining margin debit balances and falling interest rates accounted for the drop in margin interest revenues. Indeed, the absolute level of margin interest revenues fell below the 1980 figure. Thus, after peaking at 14.6% of gross revenues in 1981, margin interest accounted for less than 9% last year. This is just one sign of the fact that the revival of the capital markets has, in effect, given firms an incentive to return to stressing services and products that are attractive to customers without relying on activities generating interest rate spreads. Margin debt balances ended 1981 at $14.1 billion and declined continuously until October, 1982 after reaching a trough of just under $11 billion in September. Margin debit balances reversed direction and jumped from under $11 billion in September to just under $13 billion by year-end 1982, still $1 billion less than at the beginning of the year. This, coupled with declining interest rates, brought about a sharp plunge in margin interest revenues.

Table 6

Stock Margin Account Data

	Customer Margin Debit ($ Millions)	Approximate Average Rate Charged Clients To Carry Margin Debits
1981		
December	$14,060	14.97%
1982		
January	13,190	15.60
February	12,770	17.35
March	11,840	16.87
April	11,950	17.23
May	11,990	17.12
June	11,540	16.58
July	11,470	15.82
August	11,150	13.32
September	10,950	12.88
October	11,450	12.29
November	12,170	11.88
December	12,980	11.69

Sources: NYSE; Lipper Analytical Distributors, Inc.

Other

The undefined categories, both "Other-Related" and "Other-Unrelated" to the securities business, followed different paths last year. The "Other-Related" to the securities business continued its explosive growth by increasing by one-third in 1982, accounting for 13% of gross revenues. The category "Other-Related" is now the third most important revenue source for NYSE firms dealing with the public. In contrast, the category "Other-Unrelated" fell somewhat in 1982, accounting for less than 5% of gross revenues.

Discounters

Because of the widespread interest in the discount segment of the industry, we have elected to include their revenue breakout for 1982 in this issue. Our earlier discussion on discount brokers received a great deal of attention and included a revenue distribution for the first nine months of 1982.* These

* See "A Primer on Discount Brokerage," Securities Industry Trends, March 4, 1983.

figures have now been updated for all of 1982 and are reflected in the table below.

Table 7

Discounters Revenue Breakdown, 1982:1 to 1982:4
(millions of dollars)

	1982:1		1982:2		1982:3		1982:4	
REVENUES *	Dollars	% of Total	Dollars	% of Total	Dollars	% of Total	Dollars	% of Total
Commissions								
Listed Equities on an Exchange	27.0	52.9	26.0	47.3	36.0	50.7	57.0	52.8
Listed Options	4.0	7.8	4.0	7.3	6.0	8.5	8.0	7.4
All Other	3.0	5.9	3.0	5.5	3.0	4.2	6.0	5.5
Total	34.0	66.7	33.0	60.0	45.0	63.4	71.0	65.7
Trading Profits	-1.0	-2.0	1.0	1.8	3.0	4.2	-1.0	-0.9
Investment Profits	-1.0	-2.0	1.0	1.8	6.0	8.5	17.0	15.7
Underwriting	1.0	2.0	1.0	1.8	1.0	1.4	1.0	0.9
Margin Interest	10.0	19.6	11.0	20.0	10.0	14.1	9.0	8.3
Other - Related	2.0	3.9	3.0	5.5	3.0	4.2	6.0	5.6
Other - Unrelated	8.0	15.7	8.0	14.5	6.0	8.5	7.0	6.5
GROSS REVENUE	51.0	100.0	55.0	100.0	71.0	100.0	108.0	100.0

* Discrepancies may exist due to rounding.

Source: FOCUS

Of the $285 million in total revenues received by discounters who were members of the NYSE during 1982, almost three-fourths were derived from commission revenues and margin interest. Another 10% came from the category classified as "Other-Unrelated." To no one's surprise, discounters are much more reliant on commission business for their revenue stream and, in effect, literally ignore trading securities and the underwriting business. Although the entire industry receives more than 20% of its revenues from the "Other" category and the discounters receive about 15% from this category, there is a difference in terms of the importance of "Other-Related" and "Other-Unrelated." For all NYSE firms dealing with the public, "Other-Related" to the securities business are about four times as important as "Other-Unrelated". For discounters, "Other-Unrelated" are more than twice as important as "Other-Related."

As in our previous paper on discounters, many readers were interested in trends in their market share; thus, we have updated those estimates. In terms of gross revenues, NYSE discounters account for 1.2% of the industry's gross revenues. In terms of market share of retail commissions, we estimate that 55% of total

commission revenues were derived from retail business in 1982, or about $3.3 billion. NYSE discounters received $183 million in commissions last year, accounting for 5% of the retail commission revenues received by NYSE member firms. If we assume, as in our previous paper, that discounters charge about half the rate of full service firms, NYSE discounters probably account for about 11% of the retail share volume done by NYSE firms.

The estimated after-tax ROE of 30% for discounters gives some indication of why deposit-taking institutions have shown a keen interest in this area recently. For the first six months of 1982, it would have been unbelievable to predict that these firms would end the year earning a 30% after-tax ROE.

The extreme volatility of profitability and the ROE for discounters is attributable to their relatively high level of fixed costs and low variable costs. For example, when NYSE discount firms had a 29% increase in revenues during the third quarter, expenses rose by less than 6%. From the second to the fourth quarter of 1982, revenues for the discount firms doubled while expenses increased by only 41%. This explains the high leverage of discounters in that most revenue gains find their way down to the bottom line.

Industry Expenses

Typically, expenses move in the same direction as revenues in the securities industry but at a slower pace. For example, total revenues increased 17.3% in 1982, while the rise in expenses was 14.2%. However, a 14.2% increase is nothing to ignore. Of even more concern, almost every major expense category exceeded the increase in revenues last year. Only the decline in interest costs of almost 4% in 1982 kept total expenses from rising as steeply as revenues.

We noted before that the industry's strong performance was attributable to revenues doubling from 1979-1982. Unfortunately, total expenses also doubled during this same time period. Indeed, the three major expense categories accounting for about two-thirds of all total costs to the industry, registered representative compensation, clerical and administrative salaries, and interest costs, all doubled from 1979 through 1982. The steep rise in costs in a time of rapidly escalating revenues has helped to dampen increases in pre-tax profit margins (see Table 8).

Escalating costs in a period when we had substantial improvement in the inflation rate (10.4% average in 1981 vs. 6.1% in 1982) is discouraging, to say the least. It appears that the common folklore that costs are fixed in only one direction (downward) seems to be borne out more and more. In effect, costs seem to be variable upwards and continue to increase as business accelerates. There is very little evidence that shows any cost categories being under control except interest expense which, of course, plunged because of falling interest rates since mid-1982.

Table 8

Securities Industry Expense Breakdown, 1979-1982
(millions of dollars)

EXPENSES *	1979 Dollars	1979 % Total Revenues	1980 Dollars	1980 % Total Revenues	1981 Dollars	1981 % Total Revenues	1982 Dollars	1982 % Total Revenues
Floor Brokerage & Clearance	656.0	5.8	762.0	4.8	731.0	3.7	876.0	3.8
Registered Rep. Compensation	1,912.0	17.0	3,051.0	19.0	3,340.0	16.9	4,114.0	17.7
Clerican & Administrative	1,872.0	16.7	2,547.0	15.9	3,102.0	15.7	3,711.0	16.0
Communications	676.0	6.0	839.0	5.2	1,087.0	5.5	1,275.0	5.5
Occupancy & Equipment	428.0	3.8	517.0	3.2	664.0	3.4	856.0	3.7
Promotional Costs	250.0	2.2	347.0	2.2	458.0	2.3	533.0	2.3
Interest	2,678.0	23.8	3,446.0	21.5	5,686.0	28.7	5,477.0	23.6
Losses in Error Accts. & Bad Debts	99.0	0.9	207.0	1.3	156.0	0.8	196.0	0.8
EDP Equipment Costs	123.0	1.1	157.0	1.0	218.0	1.0	275.0	1.2
Regulatory Fees & Expenses	49.0	0.4	67.0	0.4	82.0	0.4	103.0	0.4
Partners' & Voting Stockholders' Salaries	441.0	3.9	568.0	3.5	665.0	3.4	759.0	3.3
Other	788.0	7.0	1,078.0	6.7	1,283.0	6.5	1,738.0	7.5
TOTAL EXPENSES	10,133.0	90.2	13,758.0	85.9	17,653.0	89.2	20,166.0	86.8
Net Income Before Taxes	$1,100.0		$2,262.0		$2,143.0		$3,058.0	
Pre-Tax Margins		9.8%		14.1%		10.8%		13.2%

* Discrepancies may exist due to rounding.

Source: SIA/DRI/NYSE Database

It is distressing to note that of the 12 expense lines, 10 exceeded the increase in revenues in 1982. Particularly discouraging is that the so-called "fixed" costs, such as clerical and administrative salaries, occupancy and equipment, promotional costs, all jumped sharply.

Analysts of the industry should consider whether there is any quality change in the type of personnel being attracted into the industry that would help explain rising costs. Support personnel classified in the clerical and administrative category may well be quite different in quality than those previously attracted into the industry. For example, one can envisage more computer programmers, data processing, and systems design individuals needed to handle the massive reporting and information systems required by each firm as it offers more products and services to an ever-expanding customer base. The increase in occupancy and equipment, and promotional costs probably represent both an expansion as well as an upgrading in facilities to provide for customers' and firms' needs as well as to promote new products and services.

Since account executives are compensated from three different revenue sources -- commissions generated, underwriting activities and principal activities of the firm -- it is hard to determine whether the payout ratio in terms of FOCUS reporting was changing in 1982. Another complication is the changing mix of institutional versus retail business because the institutional payout is less than the retail payout. However, the bottom line is that the sharp escalation in costs should be of major concern to industry management and has to be watched carefully if any slowdown occurs in the boom that the industry has enjoyed since mid-August. As last August demonstrated, conditions in this industry can literally change overnight. At that time, we enjoyed a change for the better; it could easily change for the worse. It is always more difficult to suddenly employ stringent cost control measures than to have such measures in place, even in the best of times such as we are now enjoying.

Expense Growth Rates, 1979-1982

Expenses increased nearly as fast as revenues from 1979-1982. The annual compound growth rate for total expenses was almost 26%. Of the twelve expense categories, ten had growth rates exceeding 25% (see Table 9). Despite the drop in interest costs in 1982, this expense item still increased by a staggering 27%. The two other largest expense items, registered representative compensation and clerical and administrative costs, also exceeded an annual growth rate of 25%.

The significant increases in total costs and individual expense items from 1979-1982 suggest that more of the industry's costs are variable than was commonly thought, or that additional revenues have forced firms to move to new plateaus in gearing up for a higher level of activity and business. This could explain

the substantial increases in supposedly fixed costs including occupancy and equipment, promotional, and EDP costs.

Profitability has been maintained because these higher expenes have been absorbed by substantial jumps in revenues. However, if revenue growth were to slow down, as it might, given the unprecedented growth rate over the last few years, the higher level of costs impose a threat to the industry's profitability.

Table 9

Compound Growth Rates of Industry Expenses
1979-1982

Expenses *	Growth Rate
Floor Brokerage & Clearance	10.1%
Registered Rep. Compensation	29.1
Clerical & Administrative	25.6
Communications	23.6
Occupancy & Equipment	26.0
Promotional Costs	28.7
Interest	26.9
Losses in Error Accts. & Bad Debts	25.6
EDP Equipment Costs	30.8
Regulatory Fees & Expenses	28.1
Partners' & Voting Stockholders' Salaries	19.8
Other	30.2
Total	25.8

* Discrepancies may exist due to rounding.

Source: SIA/DRI/NYSE Database

Conclusion

The securities industry's performance in 1982 was impressive. However, a more detailed examination of this performance reveals a concern for the future. In 1982, record gross revenues as well as high profitability occurred in a capricious quarterly pattern. It is this volatility so characteristic of the securities industry which remains of concern. Gross revenues jumped 17% in 1982, yet the after-tax profit margin rose from only 5.8% to 7.2%. In a year when record revenues were achieved, the profit margin improvement was dampened because expenses climbed by more than 14%. As important

is the high correlation between revenues and expenses since 1979. The compound annual growth rates for both revenues and expenses have correlated closely over the span, 1979-1982.*

Our analysis raises troublesome questions about expenses. Data reveal that supposedly fixed costs categories have recently had higher growth rates than total revenues. Have the spurts in expenses partly resulted because supposedly fixed costs are now variable costs? Alternatively, are expenses racheting to higher levels because of activities associated with huge volume as well diversification of business activities. Capital investment sufficient to handle volume at ever increasing peaks is necessary even though excess capacity exists during downturns. In addition, skilled personnel are required which must be retained even during slack periods.

Profitability has remained at high levels despite these expenses because of significant revenue growth. However, these expense levels are of concern because the volatility of revenues, characteristic of this industry, shows no signs of relenting. Revenue growth could slow down which would adversely affect the industry. This occurred during the first and second quarters of 1982, when 43% and 38% of NYSE firms, respectively, were unprofitable. Management should focus on limiting expense increases even when the industry is flourishing.

Jeffrey M. Schaefer
Senior Vice President and
Director of Research

Ira Epstein
Assistant Director
of Research

---

* Annual compound rate of growth for revenues was 27.4% and for expenses, 25.8%, 1979-1982.

SECURITIES INDUSTRY STATISTICS

VOLUME

	MARCH 1983	YEAR-TO-DATE 1983	MARCH 1982	YEAR-TO-DATE 1982	% CHG. Y-T-D 1983-1982
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	82.7	85.4	55.2	51.6	65.5%
AMEX (MILS.)*	7.7	8.4	4.3	4.4	90.9
NASDAQ (MILS.)*	56.3	58.2	26.6	27.4	112.4
REGIONAL EXCHANGE (MILS.)*	11.5	11.9	7.7	7.2	65.3
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	64,972	181,681	34,559	91,687	98.2
AMEX (MILS.)	2,588	7,446	1,183	3,730	99.6
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	8,234	22,489	5,444	14,872	51.2
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	17,272	46,771	10,853	28,323	65.1
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	44.4*	43.3	37.9	36.7	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	5,444	17,270	6,360	17,789	(2.9)
AMEX OPTIONS	3,001	8,925	3,030	8,750	2.0
COMMODITY	11,723	33,976	9,560	24,958	36.1

* New high

BEST AVAILABLE COPY

YIELDS
(MONTHLY AVERAGES)

	APRIL 1983	APRIL 1982	BASIS POINT CHANGE
BOND BUYER INDEX (20 BOND)	9.0	12.58	(358)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	11.51	14.46	(295)
Baa CORPORATE	13.29	16.78	(349)
RATIO Aaa CORPORATES TO Baa CORPORATES	0.87	0.86	1
MUNICIPAL BOND YIELD (MOODY'S)	8.28	11.66	(338)

PRICES
(END OF MONTH)

	APRIL 1983	APRIL 1982	% Change Apr.'83-Apr.'82
DOW JONES INDUSTRIALS	1226.20	848.36	44.5%
STANDARD & POOR'S 500	164.42	116.44	41.2
NYSE COMPOSITE	94.27	67.08	40.5
AMEX MARKET VALUE INDEX	426.38	270.46	57.6
VALUE LINE COMPOSITE	190.52	130.44	46.1
NASDAQ COMPOSITE	293.06	184.70	58.7

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	APRIL 1983	Yr.-To-Date 1983	APRIL 1983	Yr.-To-Date 1983	% Change Y-T-D '83 - Y-T-D '82
NET SALES*	2,292.8	6,584.2	393.6	1,375.6	378.6%
NET PURCHASE OF COMMON STOCK*	1,480.8	4,162.8	81.5	(319.8)	---
NET PURCHASE OF OTHER SECURITIES*	312.4	593.6	147.0	354.6	67.4
MUTUAL FUND CASH POSITION	10.6	---	12.4	---	---

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS

MARGIN DEBT

	APRIL 1983	APRIL 1982	% CHANGE Apr.'83-Apr.'82
MARGIN DEBT OUTSTANDING ($MILS)	15,260*	11,950	27.7%
NET CHANGE IN MARGIN DEBT ($MILS)	3,310	(2,680)	--
% OF ACCOUNTS WITH EQUITY UNDER 40%	9%	10%	--

* ALL TIME HIGH

UNDERWRITING
(DOLLARS IN MILLIONS)

	MARCH 1983	Yr.-To-Date 1983	MARCH 1982	Yr.-To-Date 1982	% Change March-March	% Change 1983 - 1982
CORPORATE FINANCING (Gross New Issues)						
Total	12,696	27,134	6,790	11,044	87.0%	145.7%
Common Stock	5,937	9,827	812	1,901	631.2	416.9
# Of Common Stock Issues	137	279	40	115	242.5	142.6
Preferred Stock	908	3,736	200	516	354.0	624.0
# Of Preferred Stock Issues	14	48	4	12	2.5	3.0
Corporate Debt	5,850	13,571	5,777	8,624	1.3	57.4
# Of Corporate Debt Issues	51	160	50	83	2.0	92.8
MUNICIPAL FINANCING* (Gross New Issues)						
Total	9,279	23,362	8,481	20,953	9.4%	11.5%
Notes	2,135	6,829	2,950	8,183	(27.6)	(16.5)
Bonds	7,144	16,533	5,531	12,770	29.2	29.5
# of Bond Issues	436	855	372	955	17.2	(10.5)
Negotiated Bonds	4,520	11,936	3,420	8,400	32.2	42.1
Revenue Bonds	5,035	11,991	3,350	5,790	50.3	107.1

*Preliminary Figures

These tables were prepared by Sandra N. Gallier

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	Fourth Quarter 1982	Yr.-to-Date 1982	Fourth Quarter 1981	Yr.-to-Date 1981	% Change 4th Q. 1982 4th Q. 1981	% Change Yr.-to-Date 1982-1981
REVENUE						
SECURITIES COMMISSION INCOME	2,270	6,021	1,268	5,346	79.0%	12.6%
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	2,397	6,553	1,563	4,813	53.4	36.2
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	928	2,319	405	1,572	129.1	47.5
TOTAL REVENUE	7,821	23,212	5,449	19,802	43.5	17.2
TOTAL EXPENSES	6,226	20,186	4,831	17,666	28.9	14.3
NET INCOME BEFORE TAXES	1,595	3,026	618	2,139	158.1	41.5
PERCENT OF FIRMS SHOWING LOSS	9.3%	--	26.8%	--	--	—

SOURCE: FOCUS REPORT X-17A-20

ITEM	DESCRIPTION	SOURCE
	underwritings are also presented monthly, with breakdown of conventional versus 415 deals. Contains alphabetical listing of financings by issuers and by underwriters.	
'Feldstein says 1978 Capital Gains Tax Cut Boost Revenues" Rebuttal by Joseph Minarick	Chairman of the CEA Feldstein attributes the dramatic increase in capital gains reported in 1979 over 1977 to the 1978 capital gains tax cut. Moreover, the high level of realizations in 1980, indicates that the 1979 spurt was not caused by taxpayers postponing 1978 gains. Importantly, the rise in reported capital gains meant that Treasury collected more capital gains taxes than they would have if the tax rate and reported gains remained at the 1977 level. Minarick contends that capital gains tax cuts increase realizations but not enough to increase tax revenues.	Tax Notes 5/2/83 & 5/9/83
'What's new about this Boom"	Article points out differences between new issue boom of the Sixties and of 1983. Both the size of recent issues, the companies themselves, and the buyers are very different from the Sixties. Tracks several new issues from initial underwriting negotiations to current market.	Fortune 5/30/83
'The Political Economy of Financial Regulation"	Author Carron reviews 3 major regulations that together span the major issues in financial regulation: 1. rate ceilings on time and savings accounts; 2. limitations on the investment powers of savings institutions; and 3. restrictions on the powers of banks. Contention is that rules affecting prices, products, and market entry create and maintain preferences that do not serve the broad public interest.	The Political Economy of Deregulation -- Interest Groups in the Regulatory Process 1983 American Enterprise Institute for Public Policy Research

Carolyn Hildebrandt

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
Transcript of SIA Trends Conference on "The Changing Face of Wall Street"	At the fourth annual Trends Conference, panelists from securities firms and other financial intermediaries discussed the "Changing Face of Wall Street" from their particular vantage point. The discussion focused on: linking financial products and services, the benefits of being "small," internationalization of the marketplace and strategies for coping with volatile interest rates. Panelists included George Ball, John Heilshorn, John Wing, Peter Tanous, Bill Kneisel and Steve Bansak. The luncheon speaker, Senator Paul S. Sarbanes, gave an update on Washington's view of the financial services industry.	Research Department SIA 120 Broadway - 35th Floor New York, New York 10271 $25
Capital Markets Outside The U.S.	Prepared by a special subcommittee of SIA, this booklet focuses on the size of overseas capital markets, the degree of U.S. corporate involvement in them and the extent to which continued access to these markets is vital. Includes 1980, '81, and '82 data on Eurodollar and foreign currency bond market, types of issuers and overseas issues by U.S. corporations.	Research Department SIA 120 Broadway - 35th Floor New York, New York 10271 $5
Earnings of Branch Managers in the Securities Industry	Report contains data on 1981 compensation of 1,900 branch managers employed by 40 SIA member firms, with compensation related to such factors as office gross production, RRs supervised, profitability of office and size of branch network. Sections include bonus practices of participating firms and compensation by major metropolitan area and by state.	SIA 120 Broadway - 35th Floor New York, New York 10271 Att: Madeleine Ritter $300 SIA member firm $450 All others
Directory of Corporate Financing First Annual Edition	Comprehensive, 148-page statistical reference source for U.S. corporate financings in 1982. Contents include rankings of leading investment bankers and leading syndicate managers handling the books. With comparable 1981 figures, data is presented on swaps, IPOs, underwritings by type of issuer. Total	Investment Dealer's Digest $75

Securities Industry Trends

ANNUAL SUBSCRIPTION
$30.00 member • $48.00 non-member

AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

Vol. IX No. 4 September 12, 1983

9/16/83 A8825-1

THE CASE FOR A REDUCED HOLDING PERIOD

HIGHLIGHTS

1. Using conservative assumptions, we estimate that a six-month holding period would have raised at least $200-$300 million in tax revenues for 1979-81. When estimating the impact of a reduced holding period, government staff has overlooked the dynamics of the marketplace and failed to consider gains which disappear as investors await the one-year holding period. Although their estimates of revenue losses are negligible, we and others in the private sector believe they are incorrect.

2. The impact of a change in the maximum tax rate on capital gains has been the focal point of much research work. We estimate that tax revenues would have been reduced by $2.3 billion for 1979-80 if tax rates on capital gains had not been lowered in 1978. This coincides with the work of a Treasury consultant who estimated that the effect of the 1978 tax cut was to raise revenues by $0.9 billion in 1979 and $1.6 billion in 1980.

3. Changing market conditions can precipitate "disappearing gains" as investors await the one-year holding period. For example, while individual gains from 8/5/82-8/5/83 are estimated at $383 billion, the value of stocks in the Wilshire 5000 Equity Index dropped by $88.1 billion in the period from 7/5/83 to 8/8/83. "Disappearing gains" translate to lost tax revenue for the government.

4. Recently released data show that the $200,000+ AGI class was very responsive to the change in the 1978 tax law. However, even with the decline in the maximum capital gains tax rate, tax revenues raised from this income class rose sharply in 1979 and 1980. The increased realizations of this income class generated an additional $1.7 billion in taxes.

5. The essential link between savings, investment and stable economic growth has taken a "back seat" in the debate over an appropriate holding period. The experience since the 1978 and 1981 tax cuts demonstrates the stimulatory effect of lowering taxes on investment on venture capital, stock prices, and new equity offerings.

Introduction

A turbulent economy and large projected Federal deficits have pitched tax matters to the forefront of national economic policy in recent years. Much debate has ensued over appropriate tax measures to reduce the Federal deficit and stimulate a sluggish economy without reigniting inflationary fires. There is ample evidence to suggest that a reduction in the capital gains holding period to six months is consistent with these two critical objectives of fiscal policy. Treasury Secretary Regan recently stated that a reduced holding period would encourage investment and suggested that it could raise rather than reduce Federal tax revenues. The experience since the 1978 capital gains tax cut supports this view.

For 1979-81, using conservative assumptions, SIA estimates that a six-month holding period would have raised at least $200-$300 million in tax revenues due to an increase in realizations and an acceleration in the timing of gains. Lowering taxes on investment income has proved an effective and efficient measure for fostering economic growth and increasing rather than decreasing tax revenues. The results of the 1978 capital gains tax cut and the 1981 reduction of the maximum tax on investment income document the benefits of lowering taxes on investment income in stimulating key sectors of the economy. Moreover, earlier government estimates of revenue losses attributed to the 1978 tax cut were wrong. That tax cut raised government revenues. SIA believes that a reduction in the holding period would produce beneficial economic results and raise revenues for government.

Available data on capital gains realizations by holding period are very limited. While SIA and other organizations have estimated that a reduced holding period would slightly increase revenues, government staff estimates project small revenue losses. Because the available data are limited, both government and private estimates must rely on assumptions about changes in investors' behavior. The government staff estimates overlook the dynamics of the marketplace and do not consider gains which disappear as investors await the one-year holding period.

The One-Year Holding Period: How We Got to Where We Are

From the early 1920s to the late 1970s, the holding period in the U.S., distinguishing between "speculative" and "productive" investment, was progressively reduced. Congress first legislated the separate tax treatment of capital gains in 1922, setting the minimum holding period at two years. The two-year holding period remained unchanged until 1934, when Congress introduced multiple holding periods. Gains realized after one year were subject to a rate of taxation lower than ordinary income; the longer the holding period, the lower the rate of taxation. In 1938, the multiple holding period was

modified slightly. Overall, however, the multiple holding period method of capital gains taxation proved difficult to administer.

The single holding period was once again incorporated in the Revenue Act of 1942, with gains realized after six months qualifying for capital gains tax treatment. The Senate Finance Committee believed that a shorter holding period would encourage realizations, result in additional revenues for Treasury, and sufficiently distinguish speculation from investment. The same points remain as valid for today's debate as they were in 1942. Interestingly, during the debate over changes to the holding period, Congress discussed eliminating the holding period and taxing capital gains at a flat 10% for both individuals and corporations.

The turnaround in the trend towards progressively shorter holding periods occurred in the Tax Reform Act of 1976, which lengthened the holding period to nine months in 1977 and one year in 1978. The arbitrarily-chosen time period distinguishing between capital gains and ordinary income has been questioned since the establishment of a holding period and remains a subjective judgment.

Revenue Raiser or Loser?

The Lingering "78" Debate

The Revenue Act of 1978, through an increase in the capital gains exclusion from 50% to 60% and other changes, cut the maximum capital gains tax rate from about 49% to 28%. Congress believed that the high level of taxes applicable to capital gains contributed both to a slower rate of economic growth and to the realization of fewer gains.1/ There was also discussion of the high taxes precipitating a "lock in" effect. Moreover, Congress believed that the high rates had contributed to a shortage of investment funds needed for capital formation, especially for new and small businesses. A two-fold revenue-raising effect was foreseen. First, a marked increase in the sales of capital assets would offset much of the loss from the tax cut. Secondly, the improved mobility of capital would stimulate investment, thereby generating economic activity and more tax revenue. The deteriorating international competitive position of the U.S. may also have provided some impetus for reducing taxes on capital gains.

The impact of the change in the maximum tax rate on capital gains has been the focal point of research and debate. One of the most prominent proponents of reduced capital gains taxes has been Martin S. Feldstein, Chairman of the Council of Economic Advisers (CEA). Regarding the 1978 tax cut, the CEA concluded

---

1/ Joint Committee on Taxation, General Explanation of the Revenue Act of 1978, Government Printing Office, 3/12/79.

that the sharp rise in realizations meant that the Treasury collected more revenues than they would have if the tax rate on capital gains had remained at the 1977 level. Moreover, Feldstein stated that the "experience of 1979 does provide a strong indication of a powerful effect of reducing the capital gains tax."2/

One critic of the revenue-raising implications of lower capital gains taxes is Joseph J. Minarik, Deputy Assistant Director of the Congressional Budget Office. Minarik contends that the CEA's analysis is misleading based on 1) the measurement of capital gains used; 2) special factors affecting realizations in 1978 and 1979; and 3) the CEA's interpretation of the realizations data for 1980.3/ In his rebuttal of Feldstein's position, however, Minarik concedes that "the capital gains tax cuts probably have increased the availability of venture capital and eased corporate equity financing in general; these are worthy goals."

Minarik's remarks, in turn, provoked a response from Mark Bloomfield, Executive Director of the American Council for Capital Formation.4/ Bloomfield succinctly dismisses Minarik's argument as to the appropriate measure of capital gains realizations: "It is clear that capital gains realizations are up sharply since the 1978 tax cut, no matter whose definitions are used." Table I displays the measurements in dispute. In addition, conspicuously absent from Minarik's analysis are the taxes actually paid on capital gains. These taxes increased from $9.3 billion in 1978 to $11.2 billion in 1979 and to $11.9 billion in 1980. While preliminary figures show a 5% increase in 1981 realizations for the Treasury series, taxes paid on these gains are estimated at $11.6 billion by the Treasury staff due to the 1981 tax cut.5/

2/ "Tax Rules and Capital Gains," Remarks of Martin Feldstein to the National Venture Capital Association, 4/21/83.

3/ Joseph J. Minarik, "Professor Feldstein on Capital Gains--Again," Tax Notes, 5/9/83.

4/ "Letters to the Editor," Tax Notes, 5/23/83.

5/ To prevent adverse effects on the marketplace caused by taxpayers postponing transactions until the 20% maximum rate became effective in 1982, a special rule was devised to prevent suspension of sales during the second half of 1981. Under this rule, the maximum 20% capital gains rate was effective after 6/9/81.

TABLE I

Selected Measures of Capital Gains Realizations
($ in Billions)

	Minarik: Net long-term gain less short-term loss	Treasury: Net long-term gain less short-term loss plus short-term gain	Feldstein: Net long-term gain less net long-term loss
1977	43.9	45.9	30.3
1978	48.6	50.5	37.7
1979	70.5	73.4	63.8
1980	69.9	74.6	65.3

Other economists have explored the revenue effect of the 1978 capital gains tax cut. SIA and Data Resources Inc. (DRI) estimate that, if rates had remained unchanged in 1978, tax revenues would have been reduced by $2.3 billion for 1979 and 1980. These estimates coincide with work conducted by Gerald E. Auten. Using a time series model, Auten estimates that without the 1978 tax cut, realized capital gains would have increased by only 11% in 1979 and then declined slightly in 1980.6/ Therefore, the effect of the first two years of the tax cut was to increase realizations by an average of about 33% over what would have otherwise taken place with tax revenues spurting by about $0.9 billion in 1979 and $1.6 billion in 1980.

The Continuing Holding Period Debate

Minarik analyzed the revenue effects of reducing the holding period for the Congressional Budget Office.7/ He asserts that the cost of complete repeal of the capital gains holding period is known with "confidence" to be about $400 million for a full year at calendar 1983 income levels. We disagree strongly and believe that the change in the level of savings and investment given the removal of a holding period precludes citing any estimate with confidence. Minarik's estimate rests on the assumption of static behavior on the part of investors despite changes in the risk/reward ratio that accompany changes in tax

---

6/ Gerald E. Auten, The Taxation of Capital Gains: An Evaluation of the 1978 and 1981 Tax Cut for Capital Gains, Bowling Green State University.

7/ Joseph J. Minarik, Revenue Effects of Reducing the Minimum Holding Period for Long-Term Capital Gains, Congressional Budget Office, 5/83.

law. The phenomenal growth in the use of futures and options in recent years attests to the fact that investors are tax conscious and becoming more so.

After minimizing the behavioral impact of a change in the holding period, Minarik notes that taxpayers do respond significantly to tax incentives. Data are cited for 1977 that show loss realizations accelerated as the nine-month minimum holding period was approached and dropped off sharply when it was reached, with the opposite behavior evident for realization of gains. This type of behavior shows that investors are very sensitive to the tax consequences of their actions in terms of realizing gains and losses.

Finally, Minarik notes that short-term gains are up sharply and, therefore, the costs of converting such gains to long-term could be relatively high. Based on past data, we believe that net realizations of gains in months 7-12 are practically nil, with most short-term gains realized after the first few months of ownership. Moreover, it is incongruous to argue that a healthy stock market could lead to larger losses for government from a reduced holding period. A strong stock market would encourage savings flows and the reallocation of funds now "locked" into investments. This increased savings (boosting asset prices) and activity would, in turn, lead to increased government revenues.

The New York Stock Exchange (NYSE) also disagrees with the estimates provided by the various governmental agencies. In a recent paper, the Exchange states that the "revenue loss estimate of an elimination of the capital gains holding period -- put at $400 million per year -- is grossly exaggerated because of two important omissions."8/ The Exchange study estimates that if government staff had incorporated the short-term capital loss carryover and behavioral changes of investors into their analysis, the revenue effect of a complete elimination of the holding period would be to increase Treasury revenues rather than to decrease them by $400 million.

All analysts attempting to estimate the revenue impact of a reduced or complete elimination of the capital gains holding period have a difficult assignment. As Minarik noted, "capital gains tax revenue estimates are unique, and there is as yet no consensus on the methodology." The negligible revenue impact, positive or negative, cited by various studies and the uncertainty of the science should minimize the emphasis accorded revenue estimates in this debate.

Although Minarik and the Treasury staff show negligible revenue losses from reducing the holding period to six months, SIA/DRI estimate that it would raise almost $100 million a year.

8/ Office of Economic Research of the NYSE, "Revenue Estimates of an Elimination of the Capital Gains Holding Period," Tax Notes, 8/15/83.

Whereas the Joint Committee on Taxation staff estimates that the complete repeal of the holding period would cost $400 million annually at 1983 income levels, the NYSE estimates that such a tax change would raise $29 million per year. Government's estimates of the impact of the 1978 capital gains tax cut erred in projecting revenue losses exceeding $2 billion. The actual figures show revenues swelling instead. Policymakers should not rely solely on any estimates as reasons for opposing or supporting a shortening of the holding period. All estimates of reducing the holding period to six months agree that the likely revenue impact is negligible. However, a shorter holding period would stimulate capital formation and enhance the appeal of equity investments. Moreover, a shorter holding period would persuade many investors who have benefitted from substantial gains during the 1982-83 rally to sell their assets, thereby increasing tax revenues in 1983.

"Disappearing Gains"

The recent stock market climb has generated billions of dollars of potential gains and correspondingly billions of dollars of potential tax revenues. The Wilshire 5000 Equity Index measures the total market value of all stocks listed on the NYSE and the AMEX as well as those actively traded over-the-counter. At 8/5/83, the market value of these stocks stood at $1,719.2 billion compared with $1,081.6 billion on 8/5/82. By and large, this $638 billion increase was created since mid-August 1982. Individuals directly own two-thirds of all outstanding equity issues.9/ Assuming that 60% of the $638 billion stock appreciation over the past year accrued to individuals, there has been about a $383 billion gain in the value of individual holdings. If a six-month holding period were in effect, many investors would have realized gains created since the August rally. Assuming that just 10% of those gains were realized and applying a 15% effective capital gains tax rate, potential Treasury revenues would have swollen by $5.7 billion. Although the one-year anniversary of the rally has been reached and some investors will realize handsome gains, the retail investor was not an active participant in the market rally until the early fall of 1982.

While one can hope for the continued strength of the stock market, there is the phenomena of "disappearing gains" due to changing market conditions as investors await the one-year holding period.10/ For example, rising interest rates in recent weeks have precipitated a notable decline in the value of stocks in the Wilshire Index. Measured from 7/5 to 8/8/83, the value of stocks in the Wilshire Index fell by $88.1 billion, with

---

9/ Based on Flow of Funds, Board of Governors of the Federal Reserve System.

10/ Steven A. Seiden, "Overtaxing Short-Term Gains," Wall Street Journal, 5/12/82.

a $28.6 billion drop recorded on 8/8 as markets reacted to an unexpected jump in the money supply. Opinion Research Corporation, commissioned by SIA, conducted a survey in November 1981 of executives' responses to changes in the holding period.11/ Almost one-third of the 568 executives polled reported a decline in assets that they planned to sell because of changing market conditions in the second six months of ownership during 1980-1981, with the average decline estimated at $15,714. Extrapolating for all taxpayers, Treasury losses estimated at $470-$590 million may have resulted because of the one-year holding period. These "disappearing gains" do not get reported on tax returns nor are they ever taken into account in government estimates of the impact of shortening the holding period. (Readers not interested in our summary of the methodology used in estimating the revenue impact of a reduced holding period should turn to "Who Realizes Gains" on page 13.)

SIA/DRI Measures the Revenue Impact of a Reduced Holding Period 12/

The Unlocking Effect of the 1978 Tax Cut

Experience since the change in the 1978 law is a starting point for evaluating the impact of a reduction in the holding period from 12 to 6 months. The responsiveness of realizations to that change in tax rates on capital gains can be measured and used as a standard to evaluate the impact of a reduced holding period. The data, using various series, show a sharp spurt in realizations following the reduction in the maximum tax rate in 1978. Clearly, the behavior of realizations since the reduction in the maximum tax rate on capital gains suggests substantial "unlocking." To estimate the magnitude of the unlocking effect, we had to estimate what realizations would have been if tax rates on gains had remained unchanged.

To be conservative, the percentage change in the S&P 500 since mid-1978 was used to inflate actual 1978 realizations,

---

11/ Executives' Investment Responses to Changing the Holding Period for Tax Treatment of Capital Gains, A Securities Industry Association Research Report Based on a Survey Conducted by Opinion Research Corporation, March 1982.

12/ A technical paper detailing our methodology for estimating the revenue impact of a six-month holding period is available on request.

thereby deriving a hypothetical series of gains.13/ The S&P 500 Index as an inflation factor reflects increased realizations attributable to higher market value and increased turnover.14/

Table II shows the hypothetical gains series derived by applying only the S&P 500 Index increases to 1978 actual gains. The difference between the hypothetical series and the actual series reflects the unlocking impact of the 1978 tax change. By applying the 18.32% effective tax rate on capital gains in 1978 to later years, we estimated what revenues would have been generated from capital gains if there were no change in law.

TABLE II

	Hypothetical Gains ($bils.)	Tax Rate	Theoretical Taxes Raised ($bils.)	Actual Gains ($bils.)	Actual Tax Rate	Actual Taxes ($bils.)
1978	N.A.	N.A.	N.A.	$50.5	18.32%	$ 9.3
1979	$54.2	18.32%	$ 9.9	73.4	15.62%	11.4
1980	62.5	18.32%	11.5	74.6	16.40%	12.2
1981	67.4	18.32%	12.3	78.0	14.80%	11.5

The hypothetical gain series was simulated in DRI's econometric model. If rates had remained unchanged from 1978, the government would have taken in about $1.9 billion less in individual tax revenues from 1979-81. In addition, a weaker economy would have resulted. For example, during 1979-81, real GNP would have been lower by $1.4 billion.

13/ The coefficient of determination (R^2) between realizations and changes in the S&P 500 index was .71. DRI, using time series data, studied the relationship of realizations to GNP, changes in stock prices, changes in other economic variables, and the tax rate on capital gains. With the exception of stock prices, these variables did little to explain realizations. In fact, had these correlations been used to estimate what gains would have been under the pre-1978 law, "hypothetical gains" for 1979-81 would have been substantially lower than the realizations obtained by inflating for stock price trends.

14/ To account for the time period that investors held assets, a hypothetical series was derived assuming all investors held their gains prior to 1978 and another assuming that only a portion of investors realizing gains in 1980 and 1981 held their assets prior to 1978.

Changing the Holding Period

With a measure for the unlocking effect of reduced capital gains taxes established, there is a basis for estimating the elasticity of capital gains realizations to changes in tax rates. In economic theory, elasticity is defined as a measurement of the relative change in quantity divided by the relative change in price, when both of these changes are infinitesimally small.15/ For our purposes, elasticity coefficients (see Table III) were calculated for the actual and hypothetical series by taking the percentage changes in realizations and dividing by the percentage changes in tax rates on capital gains. In this case, realizations are the quantity and tax rates, the price. Other things constant, the higher the tax rates on capital gains, the lower the realizations. Under the pre-1978 law, realizations would have been $54.2 billion instead of the actual level of $73.4 billion in 1979.

TABLE III

Elasticities
(% change in realizations /)
(% change in capital gains tax rates)

Year	% Change in Realizations	% Change in Tax Rates	e
1979	-26.2%	+17.3%	-1.514
1980	-16.2	+11.7	-1.380
1981	-13.6	+23.8	-0.570

The elasticities computed for 1979, 1980, and 1981 are the key to evaluating the responsiveness of realizations to a change in the holding period. In effect, such a change is a lowering of the tax rate on capital gains realized in months 7 to 12. We believe that if the holding period were 6 rather than 12 months, gains realized in months 7 to 12 would increase in relative terms by at least as much as the increase in realizations when tax rates on gains held for longer than one year were lowered in 1978. As there is no current data on what portion of capital gains are realized in months 7-12, the 1977 Treasury data was used. In that year (the holding period was 9 months), 5.6% of total gains reported were realized in months 9-15. That percentage was applied to both actual and hypothetical gains for recent years.

15/ See George J. Stigler, The Theory of Price, Macmillan Company, 1956, p. 33.

A reduction in the holding period to six months represents a fairly steep drop in effective tax rates on capital gains realized in months 7-12. When the percentage change in tax rates is multiplied by the elasticity coefficients in Table III, a large percentage change in realizations would take place. Currently, the value of gains realized in months 7-12 under a 12-month holding period is very small. The research work of Steven Kaplan supports this position.16/ His findings indicate that individuals do not realize short-term gains unless such gains are offset by short-term losses, and that the holding period requirement for long-term gains may actually reduce government revenues by inducing taxpayers to take their losses as short-term and their gains as long-term. Existing data show that individuals realizing short-term gains do so within the first few months of the short-term holding period and "lock in" as the line distinguishing between short-term and long-term is approached.

Revenue Impact of a Reduced Holding Period

A tax rate of 20% was arbitrarily chosen to illustrate the probable revenue impact of a reduced holding period. Assuming a 20% tax rate and using the original elasticities computed for 1979-81, the hypothetical gains realized in months 7-12 at a 20% tax rate were estimated (see Table IV). Under these assumptions, the government would have raised $200 million in additional tax revenues for the years 1979-81, if the holding period were 6 rather than 12 months.

TABLE IV

	Holding Period of Six Months			Holding Period of Twelve Months		
	Theoretical Gains Realized in Months 7-12 ($bils.)	Tax Rate on Long-Term Gains	Estimated Taxes Paid ($mils.)	Hypothetical Gains Realized in Months 7-12 ($bils.)	Tax Rate	Estimated Taxes ($mils.)
1979	$4.1	15.62%	$640	$2.4	20%	$480
1980	4.2	16.40%	690	2.9	20%	580
1981	4.4	14.80%	650	3.5	20%	700

16/ Steven Kaplan, "The Holding Period Distinction of the Capital Gains Tax," National Bureau of Economic Research, Inc., Working Paper No. 762, September 1981.

Altering the Expansion Factors

The preceding work expanded the hypothetical series by the cumulative increase in the S&P 500 since 1978, which overstates hypothetical gains for 1980 and 1981 while understating the unlocking effect. Thus, to take account of purchases of assets in recent years, certain proportions were arbitrarily assigned. For example, of those investors realizing gains in 1980, it was assumed that 75% held the assets prior to 1978 and 25% since 1979. The result of the differences in expansion factors are shown in the hypothetical gains series in Table V. With smaller expansion factors, there is a greater unlocking effect from the 1978 tax cut. Simulated in DRI's econometric model, the results indicate that, without the 1978 cut in capital gains taxes, the estimated revenue loss for 1979-81 would be $3 billion.

TABLE V

	Hypothetical Gains ($bils.)	Tax Rate	Theoretical Taxes Raised ($bils.)	Actual Gains ($bils.)	Actual Tax Rate	Actual Taxes ($bils.)
1978	N.A.	N.A.	N.A.	$50.5	18.32%	$ 9.3
1979	$54.2	18.32%	$ 9.9	73.4	15.62%	11.4
1980	61.6	18.32%	11.3	74.6	16.40%	12.2
1981	64.2	18.32%	11.8	78.0	14.80%	11.5

Once again, the estimated results for the impact of the 1978 change can be used to measure the probable impact of a reduced holding period. The greater unlocking effect generates greater elasticities. Using the same methodology as discussed previously, we estimated that for 1979-81 a reduction in the holding period would have generated an additional $280 million in revenues. This estimate exceeds the earlier "most conservative" figure of $200 million.

In sum, the revenue effect (particularly negligible estimates subject to arbitrary assumptions) should not be the only consideration for evaluating the merits of a six-month holding period. Based on realistic and conservative assumptions, our methodology shows that the government would have raised at least $200-$300 million in additional revenues if a six-month holding period were in effect for 1979-1981. Other studies cited in this paper show that complete elimination of the holding period would also raise rather than lower tax revenues. All of these studies contradict small revenue losses estimated by various government staff which do not allow for additional investment and realizations by individuals because of a shorter holding period.

Who Realizes Gains?

In addition to the revenue impact of a shorter holding period, another argument used by opponents is that such a change benefits only the "rich." This argument is steeped in emotion rather than logic. If a reduced holding period generates additional tax revenues, more money is extracted from those realizing gains, not less. Moreover, the economy will grow if people with savings invest not in gold or antiques, but in financial instruments that are used to build new plants and buy new equipment.17/

The data in Table VI show that until 1979, capital gains were centered in the income brackets between $30,000 to $100,000, with the largest percentage received by the $30,000-$50,000 AGI group. About three-fourths of all gains were received by taxpayers with AGI under $100,000. Moreover, one-fourth was received by those with AGI under $20,000 per year.

As noted earlier and in Table VI, realizations skyrocketed by about 45% in 1979 and 1980 over the 1978 level. Along with the spurt in realizations, there was a redistribution of capital gains by AGI class. The most dramatic change was in the relative share of realizations by individuals in the AGI class $200,000+. In general, while the share of realizations by this group increased in 1979 and 1980, that of individuals in the AGI classes under $50,000 fell. However, even the AGI classes under $50,000 experienced increases in realizations after the capital gains tax cut of 1978.18/

Although all AGI classes reported increased realizations over 1978 in 1979 and 1980, the most impressive increase took place in the AGI class $200,000+ which accounted for about 55% of the increase in realizations over 1978. Clearly, this income group was very responsive to the change in the 1978 tax law. Even with the decline in the maximum capital gains tax rate from 49% to 28%, the amount of revenue raised from this income class rose sharply in 1979 and 1980. We estimate that taxes from this income class rose from $3.8 billion to about $5.5 billion or almost 31%. In other words, by increasing the realizations of the highest income class, taxes paid by this group increased $1.7 billion despite a steep drop in the maximum tax rate on capital gains.

17/ Editorial Comment, "Soak the Rich?", Wall Street Journal, 2/12/81.

18/ AGI classifications in 1977 and 1978 preclude a detailed examination of gains realized by the $30,000 to $100,000 group in those years. However, given the more detailed AGI classes for 1979 and 1980, we estimate that the $60,000 and under AGI class realized about 50% of capital gains reported in those years.

TABLE VI

Net Long-Term Capital Gain in Excess of Net Short-Term Loss
(All Returns, $ Billions)

AGI ($000)	1977	% of Total	1978	% of Total	1979	% of Total	1980	% of Total
0- 10	$ 5.8	13.2%	$ 5.7	11.8%	$ 6.9	9.8%	$ 6.8	9.7%
10- 20	6.3	14.4	6.8	14.0	7.0	10.0	7.2	10.3
20- 30	6.0	13.7	6.7	13.8	7.6	10.8	6.7	9.7
30- 50	7.4	16.8	8.6	17.7	11.0	15.6	9.4	13.4
50-100	6.8	15.5	7.9	16.3	10.7	15.2	11.9	17.0
100-200	4.2	9.6	5.2	10.7	7.6	10.8	8.2	11.7
200+	7.4	16.8	7.6	15.7	19.5	27.7	19.7	28.2
Total	$43.9	100.0%	$48.6	100.0%	$70.5	100.0%	$69.9	100.0%

Note: Figures may not add to total due to rounding.

Source: Statistics of Income, IRS.

Past Experience

The debate over the appropriate holding period for capital gains has recently focused on the revenue impact in light of projected Federal deficits. The essential link between savings and investment and stable economic growth merits equally serious attention. As Minarik has stated: "the revenue effect is not the only issue in capital gains taxation and it may not even be the most important issue."19/ Both the 1978 capital gains tax cut and the 1981 tax reduction represented long-awaited steps in the recognition of the need to stimulate savings and investment. This is clearly not the time to reverse the trend towards removing tax disincentives on investment but rather the time to accelerate it. Increasing the attractiveness of stocks would help supply needed capital to business through equity financing rather than debt financing, which would tend to have positive implications for interest rates.20/

19/ Joseph J. Minarik, "Professor Feldstein on Capital Gains--Again," Tax Notes, 5/9/83.

20/ Jack W. Lavery and Joseph G. Carson, "Interim Economic Commentary," Merrill Lynch, 7/11/83.

There is considerable data supporting the effectiveness and efficiency of the 1978 tax cut. While no one factor was responsible for these trends, the reduction of the maximum capital gains tax from just under 50% to 28% and then 20% was surely one of the prime movers. Moreover, the 1981 drop in marginal tax rates served to enhance the returns from savings and investment. Although many factors enter into the decision to invest, probably none is more important than the after-tax return on investment.

Stock Market Indices

In 1979 and 1980, the economic environment was marked by record high and volatile interest rates and deterioration in the financial position of many corporations. Yet, substantial gains were recorded by the stock market indices, particularly those representing the smaller capitalized companies favored by individual investors. In the market decline of 1981, both the AMEX and NASDAQ indices fell less than the major indices. Since the revival of individual investor interest in stocks in late 1982, all market indices have performed impressively. Once again the indices representing the smaller capitalized companies outpaced the major indices. In effect, since end-December 1978 through June 1983, the AMEX and NASDAQ indices increased by a hefty 221.9% and 170.1%, respectively, and the S&P 500 and the NYSE indices each climbed by over 70%.

TABLE VII

Percentage Change in Stock Market Indices

Period	S&P 500 Index	NYSE Common Stock Index	AMEX Market Value Index	NASDAQ Index
12/78-12/79	12.3	15.5	64.1	28.1
12/79-12/80	25.8	25.7	41.3	33.9
12/80-12/81	(9.7)	(8.7)	(8.1)	(3.2)
12/81-12/82	14.8	13.9	5.7	18.7
12/82-6/83	19.5	20.2	43.1	37.1
12/78-6/83	74.9	81.7	221.9	170.1

Companies Going Public

The increased value placed on the stocks of smaller companies produced a market climate conducive to the initial public offerings (IPOs) of new and emerging companies, which create a disproportionate number of new jobs. Over 2.7 million jobs were added to U.S. industries between 1979 and 1981, with 60% of the increase in total employment contributed by small businesses with under 500 employees. Moreover, small businesses reportedly weathered the recession better than big businesses,

giving them the potential to be a major force in the economic recovery.21/

From 1969 to 1975, following increased capital gains taxes, the number of new companies raising capital plunged to a scant 15. In the first half of 1978, only 16 companies went public, raising a meager $64.2 million. When passage of the Revenue Act was imminent in the second half of 1978, 29 companies came to market raising three times the capital obtained during the first half. From 1979 to 1981, the number of companies going public increased impressively but the amount of money raised has soared. In 1981, a record-setting $3.2 billion was raised. Given depressed market conditions during 1981, the performance of initial public offerings was even more impressive.

With the value of new offerings in the first half of this year at an astronomical $5.5 billion, 1983 has already far surpassed 1981's record for dollars raised by IPOs. The market pickup that began in the fourth quarter of 1982 has set the stage for a brisk IPO market this year. According to Going Public, June saw more money raised in IPOs than any other month since the 1950s. At the end of July, there were over 200 issuers in registration, suggesting that the IPO market still has a lot of steam. Clearly, capital gains taxes are not the sole reason for the very active IPO market thus far in 1983, but they definitely are a consideration.

TABLE VIII

Initial Public Offerings

	1969	1975	1977	1978	1979	1980	1981	1982	1/83 Through 6/83*
Number of Issues	1,026	15	40	46	81	237	448	222	317
Share Value ($Mils)	$2,605	$265	$153	$250	$506	$1,397	$3,215	$1,470	$5,453

* Includes IPOs of thrift institutions. Without thrifts, 296 issues came to market for a share value of $4,580 million.

Source: Going Public

21/ The State of Small Business: A Report of the President, U.S. Small Business Administration, March 1983.

Venture Capital

Venture capital investment is an integral part of financing the development of companies in rapidly growing industries. Following the 1969 capital gains tax increase, new capital raised by venture capital firms averaged only $58 million in the 1970-77 period, reaching a peak of $97 million in 1970 and a low of $10 million in 1975. However, in 1978, venture capital firms raised a striking $570 million. After dipping to $319 million in 1979, venture capital raised leaped from $900 million in 1980 to an estimated $1.7 billion in 1982. Similarly, disbursements from venture capital firms have increased from $250 million in 1975 to almost $1.8 billion in 1982. Venture capital experts believe that the vigorous and sustained expansion of the venture capital industry resulted primarily from government actions that 1) reduced the capital gains tax in 1978, 2) relaxed pension trust investment rules in 1979, and 3) further reduced the maximum capital gains tax in 1981.22/

TABLE IX

Venture Capital
($ Millions)

	1970	1975	1977	1978	1979	1980	1981	1982 E
Raised	97	10	39	570	319	900	1,300	1,700
Disbursed	350	250	400	550	1,000	1,100	1,400	1,750

Source: Venture Economic Division, Capital Publishing Corp.

International Comparison of Holding Periods

An Arthur Andersen study, commissioned by SIA, reviewed the taxation of investment income in 11 major industrialized countries.23/ Only Sweden requires a longer holding period to qualify for long-term capital gains treatment than the U.S. Sweden requires a two-year holding period, Australia and the U.S. one year, and Germany six months. The remaining seven countries do not distinguish between long and short-term gains. Moreover, while the Economic Recovery Act of 1981 reduced the tax rate on capital gains somewhat, the U.S. tax on short-term gains remains

22/ Government-Industry Cooperation Can Enhance the Venture Capital Process, U.S. Government Accounting Office, August, 1982.

23/ Copies of this study are available at $5 per copy from SIA's Research Department.

among the highest of the 11 countries reviewed. Four foreign countries exempt capital gains entirely from taxation and an additional two countries do not tax long-term gain. Of the six foreign countries taxing short-term gains, three have rates substantially below the U.S. and three have rates slightly higher.

Conclusion

No issue is one-sided. However, the growing concern of Congress over projected Federal budget deficits has unfortunately narrowed the examination of a reduced holding period to only one factor. It is questionable whether the revenue effect should bear such heavy weight. Savings and investment are the cornerstone of economic growth. Removing tax disincentives on investment income has proved an effective and efficient method for stimulating savings and investment.

As the NYSE points out, there are two basic questions to be answered in evaluating changes to the holding period. These two questions have been grappled with since the institution of capital gains taxes and a holding period. First, does the holding period accomplish positive economic goals, and second, what is the revenue impact. The one-year holding period distorts economic behavior and leads to economic inefficiencies. The imposition of an arbitrarily chosen period marking speculative from productive investment with accompanying tax rates as high as 50% versus 20%, respectively, is a serious deterrent to the allocation of capital. The "lock in" effect of the holding period is confirmed by existing data. The optimal solution to this restraint on the free flow of capital would be the elimination or at least reduction of the holding period. Of the major industrial countries, few have a holding period distinguishing between short- and long-term gains and many have savings and investment incentives far more generous than the U.S. Despite recent reductions, the U.S. tax rate on capital gains remains relatively high.

Our research work and other recent studies conclude that a shorter holding period would increase Federal tax revenues. Both positive and negative revenue estimates are miniscule compared to Federal budgets or deficits. The promise of both increased savings and revenues should prompt policymakers to support a reduced holding period.

Jeffrey M. Schaefer
Senior Vice President and
Director of Research

Carolyn Hildebrandt
Associate Director
of Research

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	JUNE 1983	Yr.-To-Date 1983	JUNE 1982	Yr.-To-Date 1982	% Change Y-T-D '83 - Y-T-D '82
NET SALES*	1930.4	10,502.3	383.0	1923.8	445.9%
NET PURCHASE OF COMMON STOCK*	1557.0	7,351.7	266.6	(530.5)	--
NET PURCHASE OF OTHER SECURITIES*	268.3	955.7	(186.1)	542.4	76.2
MUTUAL FUND CASH POSITION	10.2	--	13.5	--	--

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS

MARGIN DEBT

	JUNE 1983	JUNE 1982	% CHANGE June'83-June'82
MARGIN DEBT OUTSTANDING ($MILS)	17,930*	11,540	55.4
NET CHANGE IN MARGIN DEBT ($MILS)	6,390	(3,330)	--
% OF ACCOUNTS WITH EQUITY UNDER 40%	8%	12%	--

* ALL TIME HIGH

UNDERWRITING
(DOLLARS IN MILLIONS)

	JUNE 1983	Yr.-To-Date 1983	JUNE 1982	Yr.-To-Date 1982	% Change June-June	% Change 1983-1982
CORPORATE FINANCING (Gross New Issues)						
Total	9,541	59,590	3,322	27,078	187.2%	120.1%
Common Stock	5,334	22,247	877	5,495	508.2	304.9
# Of Common Stock Issues	190	720	47	305	304.3	136.1
Preferred Stock	838	5,775	165	1,844	407.9	213.2
# Of Preferred Stock Issues	9	78	3	32	2.0	1.4
Corporate Debt	3,370	31,568	2,280	19,739	47.8	59.9
# Of Corporate Debt Issues	39	361	31	215	25.8	67.9
MUNICIPAL FINANCING* (Gross New Issues)						
Total	9,951	60,557	10,515	52,456	(5.4)	15.4
Notes	3,262	18,198	4,848	22,059	(32.7)	(17.5)
Bonds	8,371	42,844	5,667	30,397	47.7	40.9
# of Bond Issues	893	3,001	377	2,122	136.9	41.4
Negotiated Bonds	5,284	29,715	3,360	20,020	57.3	48.4
Revenue Bonds	4,667	29,444	3,390	19,570	37.7	50.5

*Preliminary Figures

These tables were prepared by Sandra Gallier-Philpotts

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	First Quarter 1983	Yr.-to-Date 1983	First Quarter 1982	Yr.-to-Date 1982	% Change 1st Q. 1983 1st Q. 1982	% Change Yr.-to-Date 1983-1982
REVENUE						
SECURITIES COMMISSION INCOME	2,112	2,112	1,157	1,157	82.5%	82.5%
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	2,178	2,178	1,072	1,072	103.2	103.2
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	843	843	360	360	134.2	134.2
TOTAL REVENUE	7,189	7,189	4,535	4,535	58.5	58.5
TOTAL EXPENSES	5,896	5,896	4,365	4,365	35.1	35.1
NET INCOME BEFORE TAXES	1,293	1,293	170	170	660.6	660.6
PERCENT OF FIRMS SHOWING LOSS	10.4%	--	42.7%	--	--	--

YIELDS
(MONTHLY AVERAGES)

	JUNE 1983	JUNE 1982	BASIS POINT CHANGE
BOND BUYER INDEX (20 BOND)	9.5	12.45	(295)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	11.74	14.81	(307)
Baa CORPORATE	13.37	16.92	(355)
RATIO Aaa CORPORATES TO Baa CORPORATES	0.88	0.88	--
MUNICIPAL BOND YIELD (MOODY'S)	8.76	11.55	(279)

PRICES
(END OF MONTH)

	JUNE 1983	JUNE 1982	% Change June'83-June'82
DOW JONES INDUSTRIALS	1221.96	811.93	50.5
STANDARD & POOR'S 500	168.11	109.61	53.4
NYSE COMPOSITE	97.41	63.02	54.6
AMEX MARKET VALUE INDEX	242.32	125.40	93.2
VALUE LINE COMPOSITE	204.69	120.57	69.8
NASDAQ COMPOSITE	318.70	171.30	86.0

SECURITIES INDUSTRY STATISTICS

VOLUME

	JUNE 1983	YEAR-TO-DATE 1983	JUNE 1982	YEAR-TO-DATE 1982	% CHG. Y-T-D 1983-1982
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	89.7	88.1	50.5	51.8	70.1%
AMEX (MILS.)*	10.9	9.5	3.7	4.2	126.2
NASDAQ (MILS.)*	79.5	64.6	24.9	27.3	136.6
REGIONAL EXCHANGE (MILS.)*	12.9	12.4	6.8	7.3	69.9
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	73,503*	387,136	30,699	182,658	111.9
AMEX (MILS.)	3,794	17,132	895	6,605	159.4
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	8,241	47,871	4,416	27,588	73.5
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	15,138	92,666	9,173	57,341	61.6
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	43.6	43.6	42.7	39.8	-----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	6,782	36,335	5,345	31,791	14.3
AMEX OPTIONS	3,337	18,217	2,751	15,951	14.2
COMMODITY	12,057	67,681	9,766	52,014	30.1

* New high

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
"The Role of Institutions Within the Financial Services Industry"	Pamphlet-form statement of Robert E. Linton, Chairman of SIA, before the Committee on Banking, Housing and Urban Affairs on June 16. Briefly reviews changes in the financial services industry over the past 50 years. The picture that emerges is that of Congress, on the one hand, continually seeking to keep banks focused on their primary functions, accepting deposits and making loans; and the banks, on the other hand, relentlessly pursuing loopholes and other means of sidestepping Congress' restriction, largely unimpeded by regulators. Requests examination of the financial services industry by Congress to reaffirm or change national policy.	Publications Department SIA 120 Broadway-35th Floor New York, New York 10271
Comparison of Individual Taxation of Long- and Short-Term Capital Gains on Portfolio Stock Investments and Dividend and Interest Income in Eleven Countries	Updated SIA-commissioned Arthur Andersen study provides an overview of taxation of investment income in eleven countries and a summary of the changes which have occurred in the taxation of such gains in recent years. Major change in the past two years has been the reduction of the maximum marginal tax rate on investment income from 70% to 50% in the U.S. This brought the U.S. tax treatment closer to, but still relatively harsher than, that on capital gains in other countries. The lack of corporate/shareholder tax integration in the U.S. also renders U.S. tax treatment of distributed corporate profits as one of the harshest.	Research Department SIA 120 Broadway-35th Floor New York, New York 10271 $5

BEST AVAILABLE COPY

ITEM	DESCRIPTION	SOURCE
SIA Statement Before the House Ways & Means Committee on Elimination of 30% Foreign Withholding Tax on Interest	SIA believes that continued and broadened access on the part of U.S. borrowers to overseas fixed income investment is of vital interest ot this nation's financial health and that both the elimination of the foreign withholding tax and a suitable renegotiated U.S./Netherlands Antilles Tax Treaty could attain this objective. Statement supported by charts depicting characteristics of overseas bond markets, such as volume and value, and U.S. involvement therein.	Research Department SIA 120 Broadway-35th Floor New York, New York 10271
Setting National Priorities: The 1984 Budget	The budget for fiscal 1984 projects unprecedented deficits for the next five years. The budget debate presumes that deficits must be cut; the major issues concern how. The seven contributors to this book explain the fiscal choices made by the President and examines alternatives and their budgetary and economic implications.	The Brookings Institution 1775 Massachusetts Ave., N.W. Washington, D.C. 20036 $9.95
1983 Fact Book	The 28th edition of the NYSE's Fact Book gives a statistical portrait of the Exchange Community in 1982. Designed as a reference manual, main data sections include market activity, futures, stock price trends and listed new companies.	Publications Department New York Stock Exchange 11 Wall Street New York, New York 10004 $3
"A Buyer's Guide to the Financial Supermarkets"	Reviews the managed cash accounts, as well as some of the pros and cons, now offered by banks and brokers. Chart depicting services and fees for central assets accounts of larger firms. Article concludes that the consumer will be the winner in the battle now being waged by banks and brokers.	Forbes 8/1/83

BEST AVAILABLE COPY